DAMAGE BOOK

THE INTELLIGENT MAN'S GUIDE THROUGH WORLD CHAOS

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PREFACE

THIS BOOK is an attempt, within the compass of a single volume, to give the intelligent and open-minded citizen, who wants to understand how the world has got into its present plight but possesses no special economic training, the means of unravelling in his own mind the tangle of world economic affairs. It does not profess or attempt to be a systematic treatise on Economics, or Economic History, or Money and Banking, or any other of the problems which it sets out to discuss. Anyone who wants a formal and academic treatment of these questions must go elsewhere ; and he will readily find plenty of text-books to give him such help as text-books are designed to give. But the trouble about text-books is that they are mostly written to help students to "get up" a subject, and not to enable ordinary men and women to arrive at a better knowledge of the workaday world. If my book were to be regarded as a book on Economics, written for students of that depressing subject, it would have to be condemned for a thousand faults of omission, disproportion, wrong emphasis, and at some points over-simplification of complicated questions. For it seems sometimes as if the object of the theoretical economists were to make their subject as difficult as possible in order to frighten off the amateurs.

As I am not writing for economic students, but for all intelligent people who can be persuaded to read my book, I have tried throughout to be as simple as possible, and have left out all abstruse and difficult discussions that are not absolutely vital to an understanding of *immediate* problems. I have been able to do this the more easily, because I believe that the understanding of present-day economic problems is not really so hard a matter as it is often made out to be. Even the money problem, which frightens off so many potential enquirers, is in fact largely a matter of plain commonsense ; and most of it can be understood by

anyone who is prepared to take a little trouble, if only it is presented without jargon, and with as few technical terms as possible. It may be difficult enough to decide what ought to be done about money ; but there is no real reason why this vital problem should not be intelligently discussed by ordinary people.

Indeed, at the present day it is of the first importance that this and similar problems of national and world economic policy should be intelligently discussed. For the only alternative is that they will be discussed without intelligence. They cannot be avoided, or left to the experts as matters too technical for the intelligent voter to trouble his head about. In Great Britain, the General Election of 1931 turned largely on such economic issues as the "balance of trade," the dangers of "inflation," the effects of going off the "gold standard," and the case for and against tariffs. Everyone had to have views about these questions—or to act as if he had views about them. Similarly, in the United States to-day Congress is busy balancing—or failing to balance—the Budget, passing laws for the reform of banking and the raising of the price-level, and trying to find someone or something to blame for America's economic prostration. The German and French elections have both turned mainly on economic issues ; and in every country, great or small, the world slump has forced these questions into the forefront of political controversy. No one can escape them, or fail to realise that they are of close concern to him personally as well as to the world as a whole. This book is an attempt to set intelligent people thinking more clearly about them, in the hope that if people think more clearly Governments will act more courageously and intelligently than they have done hitherto.

I begin, then, by trying to describe the world slump, and to lay bare its more obvious causes. But it soon becomes plain that the slump cannot be understood except in relation to the state of the world before it set in—and that means to the world as it was in the years immediately after the war. For the war left behind consequences which have a

very direct bearing on the troubles of to-day—reparations, war debts, re-drawings of political and economic frontiers, profound disturbances and dislocations in the economic system of every belligerent country. Ever since 1918, most countries have been trying—and failing—to get back to pre-war conditions. Only Russia, for good or ill, has been trying to build up an economic system radically new and different. We shall have to ask, then, what was this pre-war system to which the nations have been striving to return, and how it grew up, and drew country after country within its orbit, in the course of the nineteenth century. We shall have to describe its growth, and to outline its salient characteristics, in order to see whether its restoration is really something to be desired, or practicable even if it is desired.

We shall find that in this pre-war world, as in the world of to-day, two things—money and prices—largely governed men's economic doings ; and we shall have to study the behaviour of these things, in order both to find out how far they are responsible for the world's misfortunes, and to discover what can be done to make them behave less disastrously and erratically in the future. We shall have to ask how far unemployment and trade depression are mere consequences of the misbehaviour of money and prices, or arise from more deeply-rooted causes in the economic system itself. This will lead on to a discussion of the reasons why nations seem to alternate between boom and slump, prosperity and depression, and of the various attempts which they have made to protect themselves from the " economic blizzard " by tariffs and other devices designed to remedy world troubles by national means. Consideration of tariffs will lead on to the whole problem of taxation and national expenditure, of the effects of the nations' attempts to " economise," and of the huge burden of debts, national and international, by which the world is weighed down more and more heavily as prices continue to fall.

At this stage, the time will have come to look away from the nations which are striving to rebuild their shattered economic systems on the old foundations to the Russian

attempt to create a totally new economic system as a model for the world to imitate. We shall try to find out how this Russian system actually works, and with what successes and failures the Russians have met in the carrying out of their famous "Five Year Plan." The study of what has been happening in Russia will prepare the way for a discussion of the fundamental economic controversy of the modern world—the cleavage between Capitalism and Socialism as rival economic systems. We shall try to see what revolutions the various schools of Socialists and other advocates of radical change want to introduce into the world's economic affairs, and to estimate the chances of capitalist recovery as the alternative to a conversion of the world from Capitalist to Socialist ideas.

This, broadly, is the structure of the book which follows. It makes no claim to finality, or to a monopoly of wisdom; for it is written in the midst of a world crisis which is compelling every reasonable man to alter many of his ideas, and at a time when only fools can feel absolutely sure of their own rightness. I can claim for it neither completeness or impartiality—for who can either know everything or believe nothing? But I do claim to have been honest in stating facts and looking for causes, and to have set down nothing simply because it is what I should like to believe. I have tried to be objective, if not impartial; and above all, I have done my best to tell as plain and straightforward a tale as the tangle of present affairs will allow.

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Chapter I: THE WORLD CRISIS, AN INTRODUCTORY SURVEY

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§ 1. THE SLUMP

THIS BOOK is being written in 1932—fourteen years after the close of the world war and in the midst of the greatest depression which the capitalist world has ever experienced. It is a moot point, which we shall have to discuss at a later stage, how far this depression is itself to be regarded as one of the consequences of the war, or how far it arises from root defects in the world economic system. But it is pertinent at this stage to observe that. less than four years ago—ten years after the war ended—the world was already congratulating itself on its success in overcoming the economic troubles which were the legacies of war, and on the dawn of a new era of prosperity. This mood was especially marked in the United States, where it led, in almost every section of the community, to an optimism which seems now, as we look back on it, quite extraordinary. But this faith in the world's future was by no means confined to the United States. It pervaded the economic life of Europe as well ; and Europe had indeed, in the years immediately before 1929, made an even greater advance in production and trade than America. The events of the past four years have, however, everywhere shattered this facile optimism. The world no longer looks forward with confidence to a prosperity that will come to it of its own accord : it recognizes that the foundations of prosperity

will have to be deliberately laid, and that every part of the economic system, national and international, will have to be subjected to the closest scrutiny if the difficulties in which all countries are now plunged are to be successfully surmounted. The belief that recovery can be automatic, or that the slump will of its own momentum generate in due course a boom no less considerable, has completely disappeared : and men are more than ever ready, in face of their recent experiences, everywhere to reconsider those economic doctrines and policies which they have hitherto for the most part regarded as axiomatic and unquestionable.

In the economic history of the world since the war there have been four distinct phases. First there was the brief boom of the years 1919 and 1920, when the world had at all costs to repair something of the ravages left behind by the war, and there was accordingly a brisk demand both for consumers' goods and still more for new instruments of production to replace those which had been destroyed or allowed to become obsolete while the attention of nations was concentrated on the work of mutual destruction. But this boom was short-lived. It came to an abrupt end when the nations and the financiers of all countries had had time to look around them and to readjust their policies to the hard economic facts which the strange financial methods of war time had driven temporarily out of their minds. There was demand, in a sense, for all kinds of goods and for any quantity of them : but this demand was not *effective*. That is to say, the people and the nations that needed the goods had not the means of paying for them. Human need existed as strongly as it has existed at any time in the history of the world ; but there was a breakdown in the world's financial system, and, while some countries were reduced almost to starvation, others soon found themselves with a vast productive equipment of which they were unable to make use. Unemployment grew by leaps and bounds ; there was a huge fall in prices all over the world. To a period of tremendous inflation of capital values, based

on the faith that the boom would continue, succeeded a period of deflation and almost of despair. In the financial sphere, inflation in some countries—for example in Germany and France—continued a good deal longer; but gradually in one country after another financial as well as industrial deflation set in. In the years between 1920 and 1924 the world took fresh stock of its economic position and found that it had emerged from the world war, not as it had hoped richer and more progressive, but definitely impoverished and with a mass of unsolved problems on its hands.

Towards Recovery. But from 1924 onwards most countries were climbing rapidly out of the pit into which they had fallen after 1920. There was a great international movement under the auspices of the League of Nations to get currencies stabilised, and to return to the gold standard, in order to provide a stable basis for the exchange of commodities between producers and consumers in different parts of the world. There was at the same time a great improvement in productive efficiency. New inventions and processes were introduced with extraordinary rapidity, and in agriculture as well as in industry the real costs of production in terms of human labour were rapidly cut down. There was a great saving of labour through the more intensive mechanisation of industry; and a new word "rationalisation" was coined in order to find a name for what was felt to be a new phase in the history of the world economic system. Rationalisation meant indeed a good deal more than the improvement of mechanical technique; for it included the idea of reorganising whole industries as co-operative units, and of limiting though not eliminating competition between firm and firm. In this way, it was urged, and in this way alone, could the full advantages of the new machine technique be secured—by *standardisation* of production in order to promote manufacture on the largest possible scale, and by the *specialisation* of factories to particular products in order to get rid of the wastes now

seen to be inherent in the system of unrestricted competition. Germany especially set to work to replace her shattered industrial system and to repair the damages caused by her heavy casualties in the war, and by her loss of territory and productive resources. But rationalisation was by no means confined to Germany. All Europe, all North America, and indeed almost the whole world, applied it in some measure, and between 1924 and 1928 optimism reigned almost without challenge in the minds of those who were responsible for the conduct of the world's business.

It is true that, even during these years, certain countries had their special troubles. In Great Britain, for example, a good deal of unemployment continued to exist, especially in the exporting industries ; and this was intensified after the return to the gold standard in 1925. For, as we shall see, Great Britain, in attempting to restore the pound sterling to its pre-war gold value, had set herself far too hard a task. In face of the higher prices, the higher wages, in fact the higher level of incomes to which all sections of the British community had become accustomed, Great Britain could not, with the pound at its restored gold value, compete as effectively as in pre-war days in the markets of the world. Conditions in world markets had radically changed with the development of industrial production in new countries and with the erection of higher tariff barriers, especially in Europe. Under any circumstances Great Britain, more than any other country, would have been compelled drastically to readjust her entire productive system in face of the changed economic configuration of the countries with which she had been used to trade. The restoration of the pound to its old gold value made a task hard enough in itself infinitely harder than it need have been ; and Great Britain was almost alone among the countries of the world between 1924 and 1929 in feeling no assurance that her post-war difficulties had been overcome and that she could go forward confidently in the expectation of good times to come.

In the United States too there were already some signs

of impending trouble in the relative decline of the purchasing power of the agricultural part of the community, and in the steady migration of workers from the country districts into the towns. For in spite of rapidly advancing industrial production there was no corresponding expansion in the demand for labour in manufacturing industries. Rationalisation was achieving economies in the use of labour on so large a scale that there was no room in industry for the workers who were flocking into the towns ; while the limitation in the purchasing power of the farmers was already threatening to check the growth of industrial output. But Americans were for the most part in no mood to heed these signals of danger. Nowhere in the world were optimism and confidence in the future of industry carried to such lengths ; and it is not surprising that in the past four years America has rebounded from the intensest confidence into the deepest mood of business despondence that is found anywhere on the face of the earth.

For it was first of all in America that the wave of prosperity which had seemed to be sweeping over the world from 1924 to 1929 broke in a cloud of spray on Wall Street. The American panic of the autumn of 1929 speedily spread its effects over other countries ; and the success of an attempt to rebuild prosperity in the early months of 1930 by the methods of Monsieur Coué was ephemeral. By the middle of 1930 America was plunging headlong into depression ; and by the end of the year the world as a whole seemed to be heading for universal economic disaster. The main part of this book will be concerned with an attempt to discuss the causes, both immediate and underlying, of this world economic cataclysm ; but before we come to this attempt to get at and explain the facts of the present world economic situation there are certain fundamental principles that we need to get firmly into our minds.

§2. SOME FUNDAMENTAL PRINCIPLES

The economic activities of mankind have only one object—the promotion of human happiness. There is no purpose in any economic activity unless it ministers to this object. Economists have indeed often defined the objects of man's economic activity in terms somewhat different from these. They have said that the purpose of economic activity is to secure the maximum production of economic wealth. But it is necessary both to qualify and to expand this definition. For in the first place men may prefer more leisure to more material wealth, and in the second place it is impossible to leave out of account the conditions under which material wealth is created. The conditions under which men have to work may make either for happiness or for unhappiness. Work is in itself a good and not an evil; and mankind would be miserable without it. But some work—some toil, let us say rather—is very definitely an evil; and it should be the object of the economic system not merely to create as much wealth as possible, but to create it under conditions which will make as much as possible for happiness in the doing of it and as little for fatigue, disgust and sheer boredom.

We have then to look at the world economic system from three distinct points of view. How far, we have to ask, does the system as it now exists provide for a sufficiency of production? How far does it give men adequate leisure? And how far does it make for happiness and well-being in work as well as in the use of leisure?

It is often said that the demand for leisure arises among men only when material needs have been sufficiently met. But this view is radically untrue. The sustained labour of mine and factory is characteristic not of the more primitive phases of the world's economic evolution but rather of the developed industrial system under which even Western Europe and North America have been living only for a brief space in the world's history. The greater part of the world is not living under these conditions even to-day; and most

men never have lived under them. Sustained and continuous economic activity is far more characteristic of the industrialised West than of Asia or Africa, despite the long hours of work in the cotton-mills and the mines and the other industrial establishments founded on western models. The "civilised" man's perpetual complaint against the savage and against the different civilisation of the East is that men of non-European stock do not work nearly hard enough—in fact that they are lazy, by western standards. But it is also true that by his own standards of a generation or two ago the civilised man of Western Europe and of America is getting lazier. The nineteenth century was above all in the countries affected by the Industrial Revolution, the age in which laziness was taboo, and the duty of labour set at the very heart of religious and ethical doctrines.

Both Great Britain and America owed this gospel of work largely to Puritanism; and it rose to the domination of their social system with the rise of the Puritan middle class that was most active in exploiting the new methods of production. In Great Britain in the eighteenth century there is no more constant theme of complaint than the laziness of servants and artificers. Daniel Defoe harped on it continually; Henry Fielding wrote a whole book about it; it recurs again and again in Arthur Young's *Tours* and in John Wesley's *Journal*. Indeed, the great service of Methodism to the rising industrial system was that it threw the halo of sanctity round the ordinary operations of business life. The Methodist was bidden to work, and worked, to the glory of God; and in tabooing all the ordinary amusements of men he set free an enormous fund of energy to be applied to the uses of industrial production. The nineteenth century trained men to act as servants of the machine, and equipped them with a doctrine to fit their service. But in the world of to-day Puritanism has shot its bolt, and the demand for leisure is being renewed throughout the industrial countries. The sign of this is seen above all in the movements for shorter hours of labour which arose in every country on the morrow of the world war. In the nineteenth century men

struggled successively for the ten hours' day, the nine hours' day and the eight hours' day. The eight hours' day was embodied as a universal demand in the great convention drawn up by the nations at Washington in 1919. It has not yet by any means achieved full recognition in fact. But it is clear that Labour throughout the world means not only to have it, but to use the establishment of the eight hours' day as a basis for agitating for something better. Seven hours, six hours—there is no finality in the demand ; and there should be none, in face of the virtual assurance that man's productive powers will everywhere continue to increase if they are given the chance to function within a rational economic system.

The Burden of Labour. The mere duration of labour in hours is not, however, by any means an adequate measure of the amount of labour that is being expended. For its intensity as well as its duration has to be taken into account. Machinery applied to production may have two opposite effects. It may lighten the task of labour, by transferring to the machine what man had previously to do by his own physical power—and to do this is the machine's greatest service to humanity, both in making available forces which man's sheer physical power could never command, and in lightening the physical strain of daily work. But the machine can also have the effect of intensifying labour, setting by the ever increasing speed of its revolutions a hotter and hotter pace for its human attendant. Nor can there be any doubt that this speeding up by means of the machine has been a very marked feature of the movement for rationalisation in recent years. In the days before the coming of power-driven machinery most workers were remunerated by means of a piece-work price ; and the speed at which a man worked was largely his own affair and of little direct concern to his employer. The coming of the machine led at first to a great intensification of labour ; for machinery was costly, and the employer aimed at recovering the capital cost and the interest on it

by working the machine and therefore the worker who attended it at the highest possible speed. The pace of work came to be determined less by the individual worker and far more by the speed of the machine itself. Moreover, in the later nineteenth century wherever labour became more expensive there was an additional inducement to speed up the machinery in order to spread the hourly wage over the largest possible quantity of output. In the United States especially the scarcity and the high price of labour were powerful forces making for the mechanisation of industry. As Trade Unionism grew up and became powerful, one of its principal functions was to set itself the task of limiting the intensity of labour demanded from its members ; and this was one of the principal reasons why many employers set themselves in opposition to any recognition of the Trade Union movement. The same condition largely holds good to-day, as new mechanical methods are being applied in a way that more than ever makes the pace of work depend on men's capacity to respond to the drive of the machine. The methods of Mr. Henry Ford in America are the outstanding example of this sort of drive ; for the worker in a "Fordised" factory has often almost no control over his individual output. He has to stand the pace set by the machine, or he has to go. For if he gets out of step with the machine he dislocates the entire work of a large group in which he is only an insignificant unit. "High wages" have had to be paid in order to get men to submit to working at this pace ; but wages which are high if measured in terms of hours may not be high at all in terms of the intensity of effort demanded of the worker. Moreover, for the most part only the younger workers can stand the strain of the new industrialism. "Too old at forty" becomes a common cry of the factory employment manager ; and the heavier incidence of unemployment on the older workers of those countries in which rationalisation has proceeded to considerable lengths is amply illustrated in the unemployment statistics of Germany and Great Britain. Much indeed can be done by greater attention to the designing of machinery

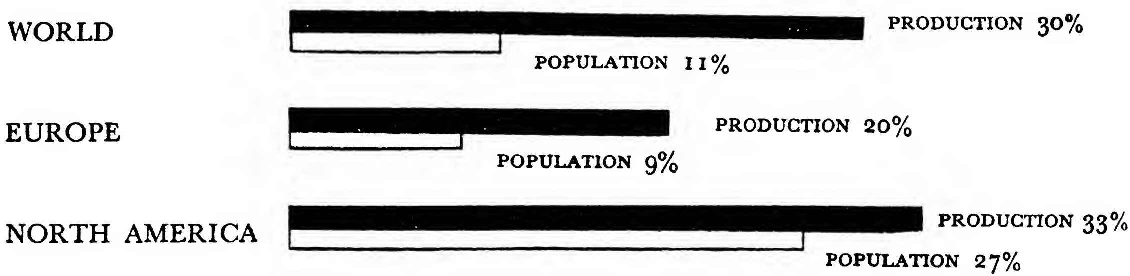
and of the factory itself from the standpoint of reducing the strain upon the worker ; and in some factories a good deal has been done with this end in view. To draw attention to the means of preventing fatigue and overstrain by better factory design and organisation of work has been the chief service performed in recent years by the industrial psychologists. But it is to be feared that most employers have taken little notice of them and of their statistics, and have even used them as a means of speeding up still further without in any way reducing the intensity of the effort demanded from the individual. But to consider this point further at the present stage would take us into a discussion of the conditions of work in their bearing on human happiness and unhappiness ; and to this we shall come back at a later stage.

The Demand for Leisure. For the present, the point which I am making is that in the developed industrial countries there is a steadily rising demand for leisure, the inevitable product of a rising standard of education and a great extension and cheapening of the facilities for amusement and recreation. This new demand for leisure is the result primarily not of laziness but of a growing sense of non-economic values and of a different valuation of economic and non-economic goods. Men are less grasping now in the economic sense than they were in the Victorian era ; and, what is more, they no longer believe that it is a virtue to be grasping. Their values have changed ; and with the change in values has come an irresistible call for a change in the methods of economic organisation and factory management. Is this alteration of human values good or bad for the world ? It is obviously good in so far as it enlarges the capacity for happiness. But there are even now many who suggest that the bad outweighs the good because it is undermining the customary incentives to hard work. It involves indeed either the devising of new incentives, or, in the alternative, the institution of a new slavery by the closer subjection of men to the machine and to those who control

the machine ; and the great struggle in the world to-day is between the attempt to find new incentives and the attempt to impose a new slavery. Capitalism is all the time trying to drive men harder within the limits set by the reduction of working hours ; while in Russia a tremendous attempt is being made to substitute a new collective incentive for the individual incentives on which the capitalist world has so far placed its reliance.

But though hours have been reduced and men are less ready than they were to subordinate non-economic to economic values, the world's productive capacity is very far indeed from having decreased. Until the coming of the world slump in 1929–30 production was everywhere rising at a very rapid pace. According to the figures compiled by the League of Nations world production of foodstuffs and raw materials rose by about 17% between 1913 and 1925 whereas world population rose only by 6%. Between 1925 and 1929 there was a further rise of 11% in production and of only 4% in world population. In North America production rose by over 26% between 1913 and 1925 and population by 19%. Up to this point Europe was hardly more than keeping pace in production with the rise of population. For Europe's population is estimated to have risen by 1%, and production by only 2 or 3% over this period. But at this time Europe was still suffering seriously from the immediate after-effects of the war; and between 1925 and 1929 there was a significant change in the situation. The population of Europe (excluding Russia) rose by about 3% in these years, whereas production rose actually by 19%. In America the rise between 1925 and 1929 was much smaller, and population actually rose almost as much as production—by about 6% in both cases. These figures relate only to the production of foodstuffs and raw materials, as there is no ready way of measuring over the world as a whole the rise in the output of manufactured goods. But it can be confidently stated that the rise in the output of finished goods was even larger than the rise in the output of foodstuffs and raw materials ; for improvements

PRODUCTION



The Rise of the Production of Foodstuffs and Raw Materials between 1913 and 1929 compared with the Rise of Population (1913=100)

in the arts of production were causing a given quantity of finished commodities to be made with a steadly falling expenditure of fuel and materials, and waste was being progressively reduced in almost every branch of production.

Rising National Production. This conclusion is borne out by the movement of the indices of productive activity published in these days by most of the leading nations. Between 1925 and 1929, according to these indices, industrial production rose to an extraordinary extent. In Poland the rise was 38%, in Canada 54%. France increased her industrial production by 30%, Sweden by 27% and Germany by 22%. The United States with 14% increase and Great Britain with 13% lagged behind these spectacular advances, but even their progress would have been regarded as remarkable in itself. The U.S.S.R. over the same period, starting of course from a very low level, more than doubled its output of industrial goods.

This increase in output was accomplished without any corresponding rise in the numbers of workers employed. In Great Britain it has been estimated officially that the physical output per worker in industry rose by more than 11% between 1924 and 1929 (Macmillan Committee on Finance and Industry. Report, Appendix 6, Table 3). In the United States production per worker was half as much again in 1927 as at the beginning of the century, and if farms and mines as well as factories are included the increase was at least three-quarters. It has been reckoned that in the six years from 1919 to 1925 the output of all American workers increased on the average by one quarter; and the increase was greater towards the end of this period than at the beginning. A sample investigation of thirty-five factories which have continuous records of output from 1919 to 1927 showed an increased productivity per man-hour of 74% over that period, and from 1924 to 1927 the increase was 39% (*Recent Economic Changes in the United States*, p. 454).

Both the world's total production of almost every kind of

commodity and the productivity per worker employed in the leading countries were thus increasing very rapidly indeed in the years immediately preceding the slump. But even at this time the actual was far below the potential production. There was much unemployment and much under-employment both of men and of physical productive resources. Great Britain never had less than a million unemployed workers registered at her employment exchanges; and the amount of unemployment in the United States in May 1929, when the financial boom was in full swing, has been put at not less than two millions. If the world at any time since 1929 had been given orders to concentrate on securing the maximum production, regardless of profit and loss or of the possibility of finding buyers for the mass of goods produced, no one can possibly doubt that an enormous increase in production could have been secured. Indeed in Russia, where this condition did practically obtain, industrial production was more than doubled between 1925 and 1929 and has continued during the world slump to increase at a no less rapid rate. From 1928 to 1929 the total index of industrial production in the Soviet Union actually stood at 388% of the level of 1923–4. Undoubtedly it would be impossible for the more developed countries to expand production quite at this rate; but I do not think I am exaggerating when I suggest that, if the technicians of the world were free to concentrate on increasing output without considering the state of the market, there would be no real obstacle to the doubling of the western world's production within a quite short period of years.

The Abolition of Poverty. The technical problem of producing enough goods to give mankind a far higher standard of living is thus, in the western world, at least well on the way to solution. In the Far East and in India the situation is somewhat different; and something will be said of it at a later stage. For the moment let us confine ourselves to those parts of the world which possess already or are

rapidly building up a developed industrial system based on the latest forms of power-driven machinery. In these countries at least, the technical problem of increasing output is not the obstacle in the way of a rapid rise in the standard of life. Improved technical methods have already expanded productive capacity far beyond what the market is able to absorb ; and there is every reason to suppose that in the coming years, unless the economic system goes down for non-technical reasons in complete collapse, invention will proceed at an even more rapid pace. In every branch of industry and agriculture the engineer, the chemist, the research worker of every kind are doing their jobs well—or ready to do them if they are given half a chance. This applies not only to mechanised factory processes, but equally to the development of agricultural production. The scientists have taught us how to grow more wheat per acre by selecting and breeding the right varieties for different kinds of soil and climate, and how to extend the wheat belt further north. Harvesting and other machinery has made possible an immense economy of labour in getting in the crops. There has been successful warfare both in tropical and in non-tropical countries upon insect pests and plant diseases. Scientific knowledge in cattle breeding and in the feeding and care of every kind of animal has greatly advanced. In industry there has been tremendous economy in the use of fuel as well as of labour, a great development of electrical power, and a cheapening of manufacturing processes all along the line. The trouble has been, not the failure of the technicians to devise improved methods of production, but the slowness of farmers and employers in adopting the new productive technique and above all the failure of the market for goods to expand fast enough to make it worth while to employ the new resources of production to the full.

§3. THE PROBLEM OF PRODUCTION

FOR UNFORTUNATELY the problem of production is not merely technical. It is a four-fold problem, involving considerations not only of technique in the scientific sense, but also of business organisation, of finance, and of human psychology. The nature of the technical problem is clear enough in its main outlines. It is primarily that of discovering the instruments of production best calculated for the performance of each special task and of devising constantly new and improved instruments in order to secure productive results with a smaller expenditure of materials and effort and to make provision for new human needs. But it has another aspect as well ; for the new machines must be made not simply as productive instruments but as instruments designed to be handled by men ; and accordingly the convenience and the degree of pleasure or displeasure involved in handling them are very material factors in their social efficiency. At this point the technical problem passes into the psychological.

Secondly, the problem of production is one of organisation. The handling of the modern instruments of production involves not simply their use by individual men, but their aggregation into productive units on a larger and larger scale. Numerous processes have to be combined within a single factory or plant, and even the work of a number of separate plants has to be closely co-ordinated in the producing of a single commodity. There is, moreover, not only the problem of co-ordinating the successive stages of production in such a way as to eliminate waste and friction and provide for smooth and continuous operation of the complicated industrial machine, but also that of buying materials on the best terms and of arranging for the physical distribution as well as for the marketing of the product. And above all there is the handling of the united labour force which is employed about any of the great modern industrial plants so as to get all the different

groups—manual workers, skilled and unskilled, technicians, managers, office staff and all the rest—working together harmoniously and all doing their best to promote the success of the undertaking. The finest plant may be wrecked as a producing concern by deficiencies in organisation. All the advantages of low production costs due to technical efficiency may be more than offset by inefficient buying or bad selling ; and the actual costs of production may mount up despite the excellence of the physical equipment of the factory because it is pervaded by a bad moral tone, a spirit of unrest or a sense that the management is not pulling its weight.

The question of buying and selling organisation obviously brings us close to the other aspect of productive efficiency—that of finance ; for a vital part of the organisation of buying and selling consists in raising the working capital required in the business on the most favourable terms. There are in all countries to-day thousands of businesses which are weighed down not by faults in their technical organisation but by topheavy capital burdens, money borrowed on unfavourable terms, and failure to place, during good times, adequate sums to reserve in order to meet the exigencies of depression. There are firms of thorough technical efficiency which are in the hands of their banks or their debenture holders, and prevented by their financial embarrassments from getting a free hand in the conduct of their productive work. There are over-capitalised firms ; and there are under-capitalised firms to which the present organisation of the capital market denies the opportunities of expansion which their technical efficiency deserves.

The Limited Market. But this is only one aspect of the problem of finance in its relation to production. For above all the problem for the controllers of modern industry is to find markets in which they can sell the goods which their factories are equipped to produce. This is, no doubt, partly the problem of producing at low enough cost ; for a business which can undersell its competitors will

generally get an adequate market for its goods. But the total size of the market also matters. A large part of what a firm gets by underselling is simply taken from its competitors, so that prosperity for one business often means adversity for others. The demand for goods may, of course be elastic—that is to say, it may expand as prices are reduced. But the demand for different commodities is elastic in very different degrees, and some forms of demand—the demand for wheat for example—are hardly elastic at all. Moreover, even if the demand for a particular commodity is elastic, it is still limited in common with the demand for all other commodities both by the limitation of the total income available in the hands of the public and by the willingness of the possessors of this income to spend it on goods at all. In recent years the world has been engaged in a strong competitive endeavour to cut down costs. Each country, and sometimes each producer in each country, has been trying to bring down his costs and prices in order to secure a larger share of the market. But where this is done, as it often is, either by cutting down wages or by forms of rationalisation involving a decrease in the number of workers employed and thus limiting the total sum distributed in wages, the effect is to limit the total size of the market ; so that at the end of a campaign of wage-cutting the demand for goods may be less than it was before, despite the fall in prices. At this point the problem of production in its financial aspect is obviously bound up with the problem of the distribution of income in the communities of the world. Its solution involves both the right distribution of the incomes arising in the course of the productive process—wages, rent, interest and profits—and also the right regulation of that mysterious form of purchasing power—bank credit—which forms an essential link in the financial chain of all large-scale industry and trade.

The Supply of Capital. A further aspect of the financial organisation of business is the provision of capital. Businesses can only carry on and expand if they can get a

constant stream of fresh capital for development, including both the increasing of their scale of production and the adoption of the newest machines and technical devices for the lowering of costs. There are, broadly speaking, only two sources from which this capital can be got. It can come out of the profits of the business itself, as it does to an increasing extent in well managed modern firms. For a well-run joint-stock company by no means distributes in dividends to its shareholders all the profits it gets. It keeps back a part—often a considerable part—for accumulation in the form of reserves ; and these reserves are used both to provide working capital and to release the business from its dependence on bank credit, and for the supply of new productive equipment. As the pace of technical change in industry increases, there is a growing tendency for machinery to become obsolete long before it is physically worn out ; and this involves the creation of special reserves against obsolescence and a decrease in the proportion of the gross profits that can reasonably be distributed as dividends to the shareholders. The shareholders often object to this policy of accumulating large reserves, as they—especially the smaller shareholders—would often prefer more income now to an increase in the capital value of their holdings. Acrimonious disputes over this question arose in Germany, for example, during the period of rationalisation, when the controllers of German industry had to fight with their shareholders over the amounts to be placed to reserve. In general the tendency in modern industry has been for prosperous businesses to finance themselves to a rapidly increasing extent by the accumulation of reserved profits rather than by appealing to the public for fresh subscriptions of capital.

For, unless a business does finance itself out of its own reserved profits, it can get the money which it needs for the expansion of its productive output only by appealing to the public for fresh subscriptions of stocks and bonds. In prosperous times this may be easy enough for the large and well-established concerns whose names are well known, but even

at such times it is often difficult for the small business, however efficient it may be ; and a large part of the sums subscribed by the public is often frittered away in interests and commissions to the various agents who assist in the floating of new issues on the market. In bad times the position is far worse than this ; for the willingness of the public to subscribe money for new industrial issues depends on the estimates which it makes of the probable profit-earning capacity of the businesses which are appealing for funds. The public is apt in such cases to take the short view, with the consequence that in bad times, when profits are hard to earn and many concerns are running at a loss, it becomes almost impossible for many businesses to raise new capital on any terms. The public will neither invest in common stocks nor lend by way of bonds to industry. It may even prefer to leave its money idle at the bank ; and it will certainly be more disposed to employ it in buying Government or municipal stocks and bonds rather than shares in industrial undertakings.

Thus we see that the accumulation of capital in industry, whether it comes from the building up of reserves or from public subscriptions of money, depends essentially on the profit-earning capacity of business undertakings. A firm cannot accumulate profits unless it can make them ; and the public will not lend or invest unless it believes that a business is going to make them. Profit is thus the pivot on which, under our present industrial system, the development of industry necessarily turns, and the possibility of profit depends on the existence of an adequate market to absorb the goods which industry is capable of producing. The questions of production and distribution are thus bound up together in this problem of the sufficiency of business profits.

The Paradox of Profits. The expectation of profit is indeed the incentive on which the modern industrial system chiefly relies in order to get goods produced. The money product of industry—that is, the price at which

goods are sold—is broken up into certain shares which are allotted to the various factors of production. The price at which goods are sold reappears in the wages, the interest, the rent and the profits paid out in the course of production. But under our present industrial system the sums paid out as profits stand in a very different relation from all the others to the productive process. Those who are in control of production necessarily regard the wages, the interest and the rents which they have to pay as costs of production which it is desirable to keep down to the lowest possible point; and the object of the productive process—the necessary object under present conditions—is to sell goods at a sufficient price to leave a margin of profit after meeting these costs. Profit thus appears not merely as *a* good but as *the* good arising out of production, and is thus contrasted sharply with wages, interest and rent.

If, however, we consider rent, wages, interest and profits not as elements in the productive process, but as incomes distributed to the various members of the community, no such contrast exists, for obviously all incomes are good, and it is good that the total income distributed to the community should be as large as possible. There may of course be faults in its distribution. Some people may get too much and others too little, and a faulty distribution of the available income may result in a diminution of the total amount of satisfaction or human happiness that the economic system affords. For it is a commonplace among economists that money is of "diminishing utility" as a man gets more of it, and that accordingly the more equally a given amount of income can be distributed the more satisfaction it is likely to afford. But no fault in distribution can make income in itself anything but a good; and it is the paradox of our economic system that it appears to treat as a good—as the end and object of the productive process—not all the forms of income which are generated in the course of production, but profits alone. On this point, which is absolutely vital to the understanding and criticism of our present economic order, there will be much more to be said at a later stage.

The Psychology of Industry. For the present, we are concerned not to criticise the present economic system but to consider the nature of the incentives on which it depends. For in this consideration of profit we have passed from the third to the fourth aspect of the problem of production. This fourth aspect is the psychological—the problem primarily of the incentives and inducements to production on which the successful conduct of industry depends. This problem of motives or inducements is becoming ever more important as the scale of industry and the complexity of economic organisation becomes greater. To the earlier economists it seemed a relatively simple problem ; and the " economic man " was invented by them as an abstraction sufficiently near to the truth to afford a satisfactory basis for the discussion of the actual working of the economic system from the human point of view. It was taken as axiomatic that the employer would set the forces of production in motion from the motive of personal gain, and that the employee in taking service under him would be actuated by a similar motive. Beyond this, no discussion of motives or incentives seemed to be necessary ; and it was assumed that, if each man would only pursue his own private gain in a reasonably enlightened fashion, the organisation of the economic world would for the most part look after itself. There was, in the minds of these early economists and of the business men whose views they interpreted and reflected, the conception of a " natural harmony," of a providential arrangement of the affairs of the universe which caused the pursuit by each man of his own self-interest to work out in such a way as to promote the common interests of all.

This view is somewhat fly-blown in these days, but it arose very naturally out of the economic circumstances of the eighteenth and early nineteenth centuries. In those days the employer who embarked on a productive process did usually realise quite simply a profit which was his own. Both his efforts and his gains were largely personal. But in modern industry the position is very different. Quite often

it is hard to discover any person who can really be called "the employer" at all; and even where the business is clearly under the final control of an individual capitalist or of a small group of capitalists the functions which the old-style employer used to perform by himself are divided up amongst a large number of persons standing in quite different relationships to the business. The gains of a modern joint-stock business do not go simple and undivided to any one person who can be called the employer. Like the functions of management they are divided between large-scale capitalist *entrepreneurs*, business managers who work partly for a salary and perhaps partly for a commission or share in the profits, and a heterogeneous mass of stock-holders and bond-holders who have no other function in relation to the business than to supply capital, and no sense of responsibility for its conduct. These last indeed cannot have any responsibility, for their number and their diffusion over a wide area, and the fact that they usually stand in the same relation to a large number of different businesses, and are constantly changing their investments, unfits them for any active share in the control of business policy. They are concerned with the company in which they invest their money simply and solely from the standpoint of the amount they hope or expect to receive in profits or interest; and only when things go radically wrong do they even make a transient appearance on the scene by way of protest. It follows that a stock- or bond-holder who stands in this sort of relation to the concern in which he puts his money can be appealed to, save in very exceptional cases, only by the inducement of the profit or interest which he expects to derive from his investment. There are indeed a few exceptional concerns, such as certain public utility companies formed for the building of garden cities, or certain corporations say for the provision of reformed public houses, into which exceptional people, actuated by a social motive, put some of their money in return for a limited dividend; but these cases are quite exceptional, and it is broadly true that in raising money for modern industry from the public the

only possible appeal is that of interest or profit. The stock- and bond-holders are of course indispensable to the conduct of business until or unless the means are found of providing capital for industry by some other method, but in the actual conduct of production they, as persons and as distinct from their money, have no function at all.

The Entrepreneur. The active business man or *entrepreneur* stands in a quite different position. He has a function ; for it is his job to control the policy of industry, to decide what forms production shall take, whether and when fresh capital shall be raised, at what prices goods shall be sold, and many other matters vital to the successful conduct of business. But in the modern world the *entrepreneur* has become much less a technician or direct employer of labour than he used to be and much more a financier. Very often he is concerned not with one particular business or one particular form of production but with a number of different businesses and branches of industry all of which he regards only as incidental to his real occupation—that of business building, company promoting, financial organisation. Great business leaders such as Henry Ford or Lord Melchett or Walther Rathenau, who are important as technicians and not only as financiers, are by no means typical. The typical *entrepreneur* is very little indeed of a technician, and not much of an employer in any direct sense. Even if he makes say matches, like the late Ivar Kreuger, his matches have become an incident in complicated operations of high finance. His actual works are controlled by technical managers on whose advice in technical matters the financier largely acts. But these managers can of course act only under the financiers' direction and within the broad policy laid down by the financial interests. Often they have no very strong financial incentive of their own and are not dependent for the main part of their incomes on the profits of the business. Usually they have indeed some financial interest in its success, and the size of their salaries may be affected by the financial returns which acrue from the

undertaking. But their attitude to business is seldom purely financial. They have also in some degree a professional conscience and a scientific keenness to make the business a technical success. Often they grow discontented at the limitations placed on them by the domination of the financial interests, and accordingly they, much more than the *entrepreneurs*, are likely to be of help if the necessity arises for building up a new economic order on a different basis.

The Wage-Workers. The old simplicity has departed not only from the motives and incentives which exist among those who direct the processes of industry but also from those of the wage-earners. The typical wage-earner of the early stages of Capitalism was a piece-worker. He turned out so much product ; and he received so much wage in return. His financial interest was thus essentially simple and similar to that of the old-time employer. To some extent this piece-work incentive survives in modern industry ; and there are even constant attempts to make it more widely applicable in order to persuade the worker to increase his output. But in many of the more highly mechanised industries of to-day the incentive of individual piece-work is ceasing to be appropriate or effective. For, as we have seen, more and more the machine and the power-house are setting the pace at which the whole body of individuals engaged in a co-operative process of production is compelled to work. The individual, having less and less control over his own output, can be appealed to less and less by piece-work inducements. It is not, however, the case that the machine does or can ever set the pace absolutely ; for it cannot set a pace hotter than the group of workers attending it, as a group, will stand. The machine can coerce the individual but not the group ; and the pace of work thus comes more and more to be determined, not by the incentives offered to the individual workman, but by the collective attitude of comparatively large bodies of men. Exceptional firms such as the Ford company may offer high wages on a time-work basis as an inducement to their employees to work harder

than men in other factories. But this inducement holds good only if their wages are not merely high, but higher than the wages which are being paid elsewhere. If all employers paid as much as Henry Ford he would lose his power to get more than the ordinary amount of work out of his employees.

Nevertheless the machine has, especially in bad times when men will put up with much for fear of unemployment, a very considerable power of speeding up. It meets, however, with an increasing resistance ; for there can be no doubt that the ordinary man of the twentieth century is, in capitalist countries, less disposed to work hard than his father and his grandfather were. He is prepared to give for fair treatment what he considers to be a fair day's work, within the limits set by his expanding desire for leisure and his demand that he shall be fresh enough to enjoy himself at the end of the working day. Moreover, as men become more critical of the capitalist order of society, they grow also less disposed to allow it to drive them hard ; and consequently the attempt to intensify the pace of labour set by the machine is more resisted. It has often been advanced as an objection to Socialism that it would make an end of the incentives by which men are now impelled to work hard enough, without providing any new incentive sufficiently strong to replace the old. But it is pertinent to observe that the country in which to-day the incentive to work seems to be strongest is Russia, where the operation of the Five Year Plan has been based consciously on the attempt to move men by a new collective incentive to do their best. In this reinforcement of individual by collective incentives Russian development is in line with the modern evolution of machine technique.

This survey of the problem of production under these four distinct heads serves to show that in the western world the obstacles to higher production and to a higher standard of life for all are not technical but arise in the spheres of business organisation, finance and human psychology ; for the two main problems are above all financial and psychological. These are, first, to find means of selling all

the goods that can be produced at a sufficient profit to induce higher production, and secondly to discover adequate incentives to persuade the various human factors to give of their best. If these two problems can be solved there is almost no limit to the possible advance in the quantity of output and in the standard of life in the western world.

What then of the Far East? What of India and China and Africa and the other great countries of the world which have as yet been hardly touched by modern industrialism? In these countries populations far vaster than those of the developed industrial countries are still struggling with the problem of primary poverty. We have defined the object of the economic process as the promotion of human happiness—the happiness of the greatest number; and we must clearly be prepared to apply this principle, not merely to the developed industrial countries of Europe and America but to the whole world.

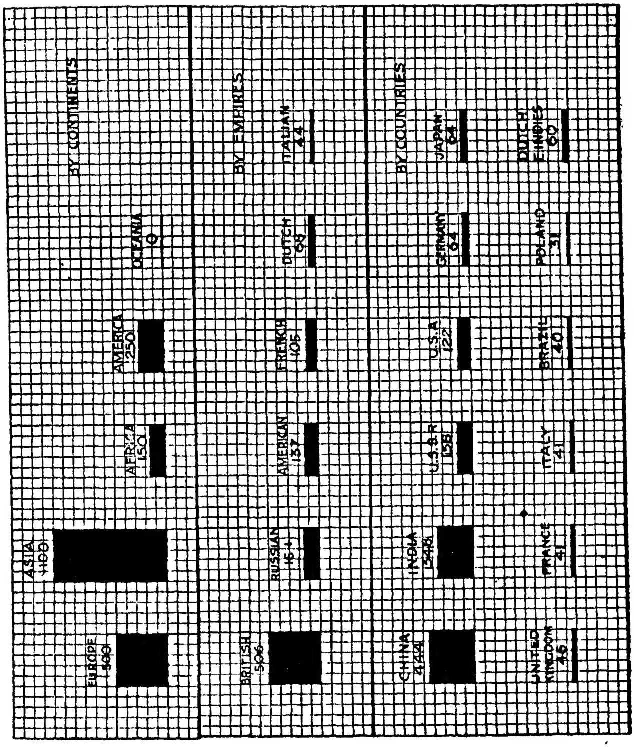
§4. WORLD ECONOMICS

WE HAVE set out to consider the *world* chaos in its relation to the *world* economic system; and we must begin accordingly by getting our proportions right. Let us never forget that, of the two thousand million inhabitants of the world, only one quarter live in Europe and one-fifteenth in North America—less than one-eighth on the whole American continent. More than one half of the total population of the world lives in Asia. China alone has nearly ten times as many inhabitants as the United Kingdom and more than ten times as many as France or Italy. India has eight times as large a population as Great Britain. Even the United States has only 122,000,000 people to China's 444,000,000 and India's 348,000,000. Next to China and India the country with by far the largest population in the world is the Soviet Union, with 158,000,000 people and a rapid rate of increase. Most of the countries of Europe are quite

tiny in relation to these vast territories. Germany has 64,000,000—roughly the same as Japan. The United Kingdom has 46,000,000, France and Italy 41,000,000 each, and Poland 31,000,000. No other country of Europe exceeds 25,000,000; and many are much less than 10,000,000. Europe altogether has rather less than 500,000,000 inhabitants, or, leaving out the U.S.S.R., 374,000,000.

The Survival of the Peasantry. Yet naturally we in the western countries are inclined to think of our own problems as far more important than those of Asia or Africa. We think of ourselves as the modern world, and of these other countries as only markets or sources of material or possible fields for imperialist rivalries and political disturbances. Many a writer tells his readers without consciousness of incongruity that the peasant is becoming obsolete, and speaks almost as if large-scale economic organisation were characteristic of the world as a whole and not merely of a minority of its inhabitants. Let us never forget in the course of this survey that a large part of the world is still living under peasant conditions—not merely under conditions for which we westerners have to go back beyond the Industrial Revolution to find a parallel, but even under conditions infinitely behind those of a large part of Europe for centuries before the Industrial Revolution. It is true that a beginning has been made with the industrialisation of the Far East and even of Africa. One country—Japan—has modernised and westernised her industrial methods at an extraordinary speed and to an extraordinary extent. But in both China and India industrialism has barely touched the fringe of economic life. Of India's 348,000,000 inhabitants not more than 2½ million at the outside are engaged in industry or in transport organised on western models, and the staple industries of the country account for barely more than a million workers. China is even less industrialised than India, and in Africa, except in the areas settled by white inhabitants, the

POPULATIONS



POPULATIONS OF OTHER COUNTRIES IN MILLIONS

Millions	
23	Spain
22	French Indo-China
21	Korea
20	Nigeria
18	Rumania
16	Mexico
15	Czechoslovakia, Egypt
14	French West Africa, Turkey, Yugoslavia
12	Philippines, Siam
11	Argentine
10	Canada, Ethiopia, Belgian Congo
9	Persia, Hungary
8	Belgium, Holland, South Africa, Colombia
7	Austria, Sudan, Algeria, Afghanistan, Arabia
6	Greece, Bulgaria, Portugal, Sweden, Peru, Nepal, Ceylon, Australia
5	French Morocco, Tanganyika, Formosa
4	Denmark, Finland, Switzerland, Chile, Madagascar, Cuba
3	Ireland, Norway, Iraq, Syria, Liberia, Gold Coast, Kenya, Uganda, Angola, Mozambique, Ruanda-Urundi, Haiti, Bolivia, Venezuela, Chinese Turkestan, Tibet, Malaya
2	Lithuania, New Zealand, Sierra Leone, Tunis, Cameroons, Guatemala, Salvador, Porto Rico, Ecuador, Uruguay, Mongolia
1	Nyassaland, N. Rhodesia, S. Rhodesia, Somaliland (Italian), Dominica, Jamaica, Paraguay, Straits Settlements, Hong Kong, Kwantung, Latvia, Palestine, Albania, Esthonia

The total population of the world was estimated at the opening of 1930 at 1,993,000,000.

technique of machine production has hardly made its appearance at all, although there has been a substantial development of cultivation of crops and production of raw materials for the world market. Egyptian cotton, Nigerian tin and a host of other products have become vital to the industries of western countries, but the greater part of African production is still essentially primitive.

Industrialising the World. The newest machines, however, are available, not only to western countries, but to the whole world, and the latest developments of machine technique tend to make it easier in many industries to use unskilled native labour, at any rate for the simpler types of large-scale production. There is no technical reason why industrialism in the undeveloped parts of the world should not proceed at an extraordinarily rapid rate, or why these countries should not equip themselves within a small space of years with instruments of production fully equal to those now in use in the developed areas. But there are other non-technical obstacles in the way—above all the shortage of native capital. In the nineteenth century the main means of bringing fresh countries within the circle of industrialism was foreign investment. First Great Britain and then other countries applied a substantial part of the huge profits of industrialisation to overseas lending, and thus one country after another became industrialised and in its turn set out to spread the new methods over a wider field. But the countries to which the Industrial Revolution has spread during the past century have been either countries which had already advanced to a considerable degree in civilisation, wealth and technical capacity under an earlier economic system—such as France or Germany—or countries in which a sparse population found itself in possession of vast and easily exploitable natural resources—such as the United States of America, the Argentine, or Australia. The problem of industrialising densely populated and deeply impoverished countries such as India or China is quite different. For it is very difficult for thickly settled

OCCUPATIONS OF THE PEOPLE
PERCENTAGE

Country		Agriculture and Fishing	Mines and Quarries	Industry	Trade
United States	(1920)	26.3	2.6	30.8	10.2
England	(1921)	6.8	7.5	39.7	13.9
France	(1921)	41.5	1.5	28.4	10.4
Germany	(1925)	30.5	3.2	38.1	11.7
Italy	(1921)	56.1	0.6	24.0	6.4
Poland	(1921)	75.9	0.7	8.7	3.8
Czechoslovakia	(1921)	40.3	2.7	34.1	6.0
U.S.S.R.	(1926)	86.7	6.1		1.4
Sweden	(1920)	40.7	0.8	30.2	8.4
Belgium	(1920)	19.1	6.6	39.9	10.7
Denmark	(1921)	34.8	—	27.0	10.8
Holland	(1920)	23.6	1.7	36.1	11.7
Canada	(1921)	35.0	1.6	26.9	13.0
India	(1921)	72.3	0.3	11.2	5.9
Australia	(1921)	22.9	2.9	31.2	15.3
New Zealand	(1921)	27.1	1.6	27.5	15.5

IN VARIOUS COUNTRIES
DISTRIBUTION

Transport		Armed Forces	Public Services	Professions	Domestic Service	Others
Shipping	Other					
0.4	7.0	0.5	1.3	5.2	8.2	7.5
1.9	5.1	6.5		4.4	11.8	2.4
0.3	5.9	2.0	2.6	3.5	3.9	—
0.5	4.2	0.4	2.0	4.1	4.4	0.9
4.0		2.0	1.5	3.0	2.4	—
—	1.8	2.6	0.8	1.6	2.1	2.1
—	4.0	2.3	1.9	2.8	4.3	1.6
1.6		—	2.3		—	1.9
1.5	4.4	0.7	1.1	3.8	7.0	1.4
0.8	6.8	2.2	3.3	3.6	5.0	2.0
1.3	4.6	0.7	0.8	5.5	13.3	1.2
3.3	6.3	0.6	1.1	6.5	8.1	1.0
0.7	7.1	0.2	2.8	6.0	6.7	—
0.2	1.2	0.3	1.1	1.5	1.8	4.1
2.1	6.9	0.4	1.7	6.5	9.0	1.1
3.2	6.7	0.3	1.0	8.4	8.7	—

peasant countries like India to accumulate capital and to apply it to industrial development out of their own scanty resources. Japan with her smaller population achieved this, without a great deal of foreign borrowing, largely by the diversion of her feudal wealth. Russia, far less densely populated and with huge natural resources awaiting development, is doing it to-day at a rate which provokes the alarm and astonishment of the western world. But even Russia is doing it only at a heavy sacrifice of present goods, and by calling upon her people for an effort which makes huge demands on their collective faith and ambition. Nor could it be done at all in Russia without something like a dictatorship—that is, without a strong central government capable of making its orders felt imperatively through the length and breadth of a vast peasant country. Even if India and China were under some form of Communist dictatorship, their task would be far harder even than Russia's because of their denser population and the even greater difficulty of abstracting from the current product enough to form a fund for the development of capital resources.

It is true that the investors in the western countries, where there is a relative abundance of capital, are prepared up to a point to invest in China or India or Africa or wherever they feel a sufficient assurance that profits can be made. It is true that the directors of the constructional industries in the developed countries have a strong motive for promoting industrialisation in the rest of the world in order to find an expanding market for their goods. Unless these conditions had existed neither China nor India would ever have got their present railway systems or their factories which have been equipped with modern machinery. Cheap labour has served in some measure to attract western capital into the less developed countries; but the pace of industrialisation has been slow in relation to the technical opportunities. For the market must expand in order to make it worth while for the western capitalists to invest their money in these countries on a large scale. But the market cannot expand until a larger proportion of

the inhabitants have been lifted out of the conditions of primary poverty. There is a vicious circle which only the Russians, by a simultaneous expansion of production and consumption under a national plan, are seriously attempting to break.

What World Unity Could Achieve. If the world really recognised the brotherhood of man, or if the League of Nations were a really international force, all countries would be working together to promote the economic development of the world as a whole and to lift the inhabitants of Asia and Africa out of their secular indigence. But in fact national jealousies, imperialist rivalries and competitive industrialism stand in the way, while the resistance of the eastern world to imperialist penetration sets up conditions of political insecurity which check the investment of capital from overseas. Moreover, in a world of unstable prices it is dangerous to borrow, for debts may have to be repaid at a terribly burdensome rate in terms of commodities. The fall in the price of silver, for example, has enormously reduced the purchasing power of China and increased enormously the burden of debts payable in gold or foreign currencies, and everywhere the fall in the prices of primary commodities has made the debt burdens of the borrowing countries heavy out of all proportion to the real value of the loans. Stable currency conditions and terms equitable between borrower and lender are essential to the progress of economic internationalism. If the aim with which we were all working were to increase the total wealth of the world rather than to reap sectional advantages for our own particular countries, it is clear that by far the greatest advance in world wealth could be secured by a tremendous campaign of industrialisation in India and China. This could be on a scale sufficient to keep all the constructional industries of the developed countries fully employed for a long time to come. But Economic Imperialism, attempts to monopolise the colonies as markets and sources of supply for the dominant Powers, and the

resentment of the inhabitants of the less developed countries at their treatment, which makes investment insecure, effectively prevent the rapid increase of wealth over more than one half of the world's surface, and condemn more than half the world's inhabitants to an altogether unnecessary continuance of primary poverty.

There is of course nothing new about this failure of the world to make full use of the technical powers of production. The world has never taken anything like full advantage of the economic opportunities technically open to it. At every stage it has been held back from doing this—partly by its division into arbitrary political units with frontiers corresponding not at all to real economic divisions, and partly by its limited capacity for organising the technical forces which the progress of science has placed at its disposal and of arranging the conditions of distribution so as to correspond with the expanding powers of production. For at every stage in the world's history since the modern economic system began there have been artificial tariff barriers and political impediments to the free movement of trade. An acute shortage of capital in one area has coincided with a surplus power to produce capital goods in another, and governments and business men, where they have not been positively stupid and short-sighted in economic matters, have still been thinking in terms of the prosperity of their own countries and industries rather than of the whole world or the whole industrial system. If full use had been made of the technical resources which the nineteenth century placed at man's command, the problem of primary poverty would not merely be in sight of solution for a large part of the world, but would have been solved long ago. But as I write these words, and suggest that even to-day the problem of primary poverty is within sight of solution, I am conscious that this hope is at best conditional and speculative. It is indeed difficult to believe that with the vast productive resources now at command the world can fail much longer to solve this problem; but it has to be remembered that its solution depends, not only on the

technical forces available, but also on the sustained existence of an economic and political order capable of keeping these forces at work. As one looks around the world to-day it is impossible to feel any confidence that the problem of poverty will be solved within the framework of the present economic system. For this system seems everywhere threatened with a collapse which will make mock of its technical competence.

The Choice Before Us. There are, indeed, three possibilities ahead of us—a reconstruction of the present economic order on a basis which will at last allow the technical powers of production to be fully employed and exploited at a more rapid rate, the substitution of a new and radically different economic order designed to achieve the same result, and the dissolution of the present order into chaos. If this third thing happens—and no one can say with confidence that it will not happen—then the outlook for the world is black indeed. We have, therefore, to make up our minds, by the closest and most objective study of the facts and tendencies, which of the other two courses we propose to pursue. Are we to try and rebuild the existing system on a broader, more inclusive and necessarily more collective basis—creating a new world Capitalism with a world outlook in place of the sectional and conflicting Capitalisms of to-day? Or are we to make up our minds that Capitalism, necessary at one stage of the world's economic development, has done its work and no longer fits the technical powers of production that are at man's disposal in the twentieth century? This is the vital decision which every intelligent man has to make for himself in the present crisis, and this book is mainly concerned with an endeavour, by studying the facts and tendencies as dispassionately and objectively as possible, to provide the essential basis for the intelligent man's personal judgment.

On the face of the matter, the outlook for world Capitalism is by no means reassuring. For the crisis of the past few years consists fundamentally of the failure of the present

economic system to adapt itself to technical forces which have been changing with unexampled rapidity. Since 1929 the world has shown itself less and less able to make use of a more and more rapidly increasing power to produce. Neither the United States with its relative self-sufficiency, nor Great Britain with its elaborate system of specialised production for the world market, has been able to stand out against the forces making for disintegration and decay. It has been shown conclusively that the whole world does constitute one single economic system, and that it is impossible for prosperity in any part to co-exist with depression and crisis elsewhere. But though the world *is* one economic system it refuses to behave as one. Indeed, its reaction to the crisis has been everywhere an exaggeration of sectional and nationalistic tendencies and an attempt by each nation and group to take shelter behind artificial barricades from the impact of the world crisis. So far from building up a world economic system corresponding to the needs of the twentieth century, Capitalism has been fast destroying such internationalism as it did already possess. This, it may be said, is but a phase of instinctive scuttle for safety under quite abnormal conditions and the prelude to a real attempt to rebuild Capitalism as a world system of economic co-operation. But where are the signs that this is happening, or that the statesmen and business leaders are even beginning to think in terms of a new co-operative world order? We need not say at this stage that Capitalism cannot or will not reconstruct itself, but it is impossible to avoid the conclusion, even from a preliminary survey of the situation, that this work of reconstruction has neither begun nor seriously entered into the minds of most of those who are at present in control of world policy.

Most of us are in fact extremely reluctant to face the truth of the present world situation. The human mind has an instinctive desire for finality. It wants to think of the world as static and unchanging, and of the solutions which it applies to its problems as final solutions, valid once and for all. In the nineteenth century the main outlines of the

economic system seemed to most people fixed and certain, and there was, save among small groups of Utopians and Marxian Socialists, hardly any questioning of the fundamental basis of the economic order.

Looking Backward. But anyone who now looks back dispassionately at the conditions of the nineteenth century is bound to realise that those conditions were in many respects extremely artificial. They arose out of a particular situation which could not possibly remain long in being. By what was little more than a historical accident the Industrial Revolution—that is, the introduction of an industrial system based on machine power—took place in Great Britain at a time when the rest of the world was not in a position to take advantage of the new powers of production placed at man's disposal by the inventions of the eighteenth and early nineteenth centuries. Great Britain thus obtained over all her competitors a long lead in industrial efficiency; and she proceeded very naturally to take advantage of the tremendous opportunities thus placed within her reach by pushing economic specialisation to the furthest possible point. She was able to produce almost every class of goods to which the new machine technique could be applied a great deal more cheaply than any other country. This gave her the pick of the world's markets over all the wide and growing range of products which could be produced under the new conditions. It also gave her exceptionally high profits at a time when the power of the working class to enforce higher wages was far too small to secure a rise in the standard of life at all commensurate with the expansion of productive capacity. The huge surplus generated by the new industrialism was thus largely available for the accumulation of capital, and Great Britain added to her monopoly of the new productive powers the possession of a capital surplus which gave her the control of economic development not only at home but to a great extent throughout the world. The British industrialist under these conditions naturally selected as the field for his

productive activity those commodities in which the new machine technique gave him the greatest comparative advantage. He began with cotton goods and the development of the textile trades—in other words, with consumers' goods —but in the second phase he passed on from clothing the world to equipping it with the instruments of transport and production. He built the world's railways, equipped the world's docks, undertook the provision of public utility services in every quarter of the globe, and before long began also to sell the world machines wherewith to imitate his own productive methods. It was largely through the radiation outwards of the new industrialism from Great Britain that the technique of power production spread to other countries, although from the first the United States pursued to some extent an independent course of development based on its own native capacity for invention. The steam engine and the locomotive, the blast furnace and the steel plant, were to some extent evolved separately and on different lines in Great Britain and America. But the United States remained for a long period mainly an agricultural country, and industrialisation, when it developed on American soil, found for a long time an adequate outlet for its activities in the domestic market. The Americans in the nineteenth century were under no necessity to export machinery and other capital goods, for there was ample demand for them at home. Nor had they, like Great Britain, any surplus of capital for overseas investment, for the vast resources of their own territory and of their rapidly expanding population created a need for even more capital than the American public was able to supply. Right up to 1914 the United States continued to import capital from abroad, and the country which is an importer of capital cannot take the lead in world economic development.

British Supremacy. Great Britain thus became in the nineteenth century the supreme example of economic specialisation more and more dependent on foreign countries and on her Empire for the supply, not only of essential

foodstuffs, but also of raw materials for her developing industries. She pushed specialisation in the production of a limited range of manufactured goods for the foreign market much further than it has ever been pushed by any other country. Moreover, her extreme specialisation reacted to cause specialisation elsewhere ; for the vast and rapidly expanding market which she offered for foodstuffs and raw materials caused the countries of the new world, such as Canada and the Argentine, to become as specialised in certain forms of agricultural and primary production as Great Britain had become in manufacturing industry. A great system of world interdependence thus began to be built up, mainly on account of British specialisation in manufacturing products, and this system of mutual dependence underlay the nineteenth century philosophy of Free Trade, which, as Adam Smith pointed out a hundred and fifty years ago, is nothing more than the international division of labour. But whereas the countries of the new world developed a specialisation in the output of primary commodities as the complement to the industrial specialisation of Great Britain, the Industrial Revolution took a different course in its expansion through the other nations of the old world. Germany especially, and to a less extent other European countries, set out, not to build up an economic system complementary to that of Great Britain, but rather to rival the British manufacturer. They could not, however, hope at first to do this under the conditions of Free Trade. For Great Britain had too long a lead in industrial efficiency and too great an advantage both in the abundance of capital at her command and in her possession of a great body of skilled technicians and manual workers. The new industrialism accordingly developed in Germany and in other European countries, as it did also for somewhat different reasons in the United States, on a basis of tariff protection ; and behind tariff walls the older countries which had been later in adopting the new productive technique began to build up manufacturing systems directly competitive with the British. For some time these new

countries were too busy supplying their own home markets to compete seriously with Great Britain as exporters, and the British manufacturer was able to meet his gradual exclusion from their home markets by using his resources of capital to push demand elsewhere, and by devising new forms of production to meet new needs. His monopoly of the new productive technique was, however, being steadily undermined as workers and technicians in new countries learnt the methods of industrialism and accepted the discipline of the factory system. Right up to 1914, despite this rapid growth of competitive forces, British exports continued to expand, for the opening up of new markets and the provision for new needs more than offset the rise in foreign countries of industries directly competing with those of Great Britain. But the position as it existed in 1914 was inherently unstable and was marked by a growing competitive pressure especially for the capture of the markets of the less developed countries and for the monopoly of the newly discovered sources of raw material supply.

Britain's Lost Monopoly. Great Britain's position, though satisfactory for the moment, was highly precarious because the evolution of the new machine technique was tending to reduce her lead in productive efficiency. The new machines were inevitably available for buyers in all countries. The standards of technical competence and manual skill in other countries were rising fast ; and the new machinery itself was becoming more and more "fool-proof." The skill of the operative was, over a wide range of processes, being transferred to the machine by improvements in design ; and the premium upon the exceptional manual skill of the British operative was therefore being progressively reduced. The British worker had a higher standard of life than the worker in any other European country. This standard of life was all too low in relation to Great Britain's power of producing goods, but it was beginning none the less to handicap the British employer in his

competition with low-wage labour in foreign countries using the new fool-proof machines.

In short, long before 1914, Great Britain had lost her monopoly and was no longer free to pick and choose among all manufacturing products those with which she would supply the world. She was being compelled to compete more and more by price cutting with rival producers, and her field of comparative advantage was getting narrower, while the eagerness of other countries to enlarge their share of the world market was increasing steadily. The obvious remedy for the situation, from the British point of view, was for other countries to raise their wages as their productive powers increased, and this was also the right solution from the world point of view. But manufacturers abroad did not see the matter in this light. They were concerned to get a larger share of world trade, and low wages were an important factor in their competitive campaign. Their competition in turn reacted on the British wage level ; and in the first decade of the twentieth century the rise in real wages in Great Britain, which had been steady and progressive throughout the latter part of the nineteenth century, was decisively checked. Even if there had been no world war, there were in existence in 1914 world forces threatening a serious dissolution of the established harmony of the nineteenth century industrial order. Perhaps that was why there was a world war.

The Gospel of Free Trade. During the period when British manufacturing industries had almost a monopoly of the world market, economists, statesmen and business men in Great Britain, flushed with success, were disposed to argue that Free Trade based on the international division of labour was the right policy, not merely in Great Britain, under the peculiar conditions which then existed, but for the whole world and for all time. It seemed to Bright and Cobden and to the theoretical economists who interpreted the views of the Manchester School that the conquest of the world by Free Trade and international specialisation could

be only a matter of time. For a while, indeed, the resounding success of British economic methods gave Free Trade in other countries so great a prestige as to convert many foreign economists and statesmen to a belief in it. Bastiat in France pushed the doctrines of Free Trade fully as far as Cobden in Great Britain. There was a brief period in the mid nineteenth century when all Western Europe seemed to be heading for Free Trade, and even in the United States of America the dominant protectionist ideas were for a time giving way. But this missionary success of British economics was short-lived ; and before long other countries veered round again to the opinion of Friedrich List, and set out to develop their ' infant industries ' behind tariff walls in the belief that only by mastering the technique of power production in the industries in which Great Britain was a specialist could they hope to continue as Great Powers under the conditions of the modern world. In the last two decades of the nineteenth century and in the first decade of the twentieth tariff walls rose rapidly throughout the world ; and even the countries which were specialists in the export of raw materials and foodstuffs began to be anxious to build up manufacturing industries of their own and to use tariffs as their instrument. All this added seriously to the instability of the world economic order ; for almost everywhere the industries which the protectionist countries set out to develop were precisely those on which British specialisation had been based. There was a tendency to increase world productive capacity in certain key branches of manufacturing industry, and especially in the industries producing capital goods, because the growth of these forms of production seemed to each country to be indispensable as the foundation of an industrial system capable of playing an independent or significant part in the world economic order. Universal Free Trade, so far from being realised, became more and more obviously out of the question. It was a dream, and a dream based on a world economic situation which had definitely ceased to exist. This of course did not mean necessarily that the time had come for Great

Britain to modify her own Free Trade attitude. For Free Trade might continue, owing to her special circumstances, to pay her best, even in a protectionist world. But the passing of the dream of universal Free Trade did mean that most countries had determined to develop their own economic systems under some sort of collective guidance. Tariffs are, indeed, commonly very far from being scientific or calculated to promote the advance of those industries in which a country has the best chance of making itself productively efficient. But the idea of a tariff, with its power of promoting the development of one industry and retarding that of others, was definitely the first step towards the idea of national economic planning. The recrudescence of tariffism in the world meant a definite abandonment of the notions of an underlying economic harmony and of *laissez-faire*, and the adoption of the contrasting view that the shape and direction of economic activity should be brought under some form of conscious control.

Nationalism and Imperialism. If, however, tariffs were to be the sole or even the main instruments of economic control, this meant that the world's economic forces were destined to pass more and more under the sway of rival nationalist or imperialist groups. For tariffism, if it is the assertion of the idea of national planning, is also the direct negation of any planning on an international scale. It substitutes within the nation the idea of unified economic development for that of the unfettered individual competition with which the nineteenth century Englishman had fallen in love. But it does this at the cost of treating each nation as an absolute economic entity entitled to follow a purely self-regarding policy of its own, and to engage in a perpetual economic warfare with all its neighbours. The passing of the idea of universal Free Trade meant that the world had to think for the future in terms, not of *laissez-faire*, but of conscious planning; but it meant also that, unless planning could be made international as well as

national, the conflict of nationalisms was bound to lead the world headlong to economic disaster.

For unrestrained economic nationalism, while it may be a *possible* policy for certain countries, is assuredly a disaster for most, and for the world as a whole. It is most obviously disastrous to the country which adopts it where a small nation endeavours to build up behind a wall of tariffs and prohibitions a largely self-contained economic system ; for many of the industries of the modern world are essentially of a kind in which manufacture for a very wide market is indispensable if the economies of modern large-scale production are to be achieved ; and it is clearly out of the question for a small country to develop large-scale production in these industries for its own home market, or to make itself efficient enough over a wide range of products to afford its inhabitants a reasonable standard of life. The present complicated customs barriers of eastern and southern Europe are, from the standpoint of world economic efficiency, merely absurd; for it is impossible for these little countries with only a few million inhabitants to be anything like self-contained without a tremendous sacrifice in productive power. The case of a vast country with huge and diversified resources and population may indeed be very different. But even such a country, though it can push the idea of self-sufficiency very much further than the small nations of Europe without disaster to itself, finds impassable limits set to its pursuit of economic nationalism. Not even the United States can make itself self-contained in the supply of raw materials or even foodstuffs, and it must therefore sell a large quantity of goods abroad. Above all, when once a country becomes financially a creditor of others, and seeks to export capital goods, it must be prepared to take payment in the commodities which its debtors are able to supply. The United States became a creditor country through the World War ; and, although the American people have not yet fully realised what has happened to them, that meant in fact that the policy of economic nationalism was bankrupt even on the American continent.

The modern world, then, is confronted with a situation in which universal Free Trade is impossible, and the universal tariffism to which resort has been tried as an alternative results in an unnecessary lowering of the standard of life and in a disastrous dislocation of the natural movement of goods from country to country. There is in the modern world no universal case for either Free Trade or Protection ; but there is an overwhelming case for an attempt at world economic organisation. The nations will have to take part in building up for themselves an organised world system based on the reconciliation of national rather than the protection of vested interests. And this system must above all be flexible and capable of rapid adaptation as conditions change. One of the worst features of tariffism is its rigidity, for the effect of every tariff is to create a host of vested interests in the protected industries, and these vested interests make the economic system rigid and unadaptable at a time when the technical conditions of production are changing more rapidly than ever before. Whether the new order is to be capitalist or not, we can say confidently even at this stage that it must be a world order, and that the attempt of the separate countries to shelter from the economic blizzard by a policy of national exclusiveness is bound to mean chaos and collapse.

A Ludicrous Situation. For—to sum up what we were saying—to any intelligent person who looks at the world as it has been during the past few years the situation is bound to appear above all else simply ludicrous. There has been in the past two decades throughout the world a tremendous advance in productive power—a much greater advance than ever before in history, not excepting the period of the Industrial Revolution. This advance has extended not only to manufacturing industry but to agriculture as well ; so that on all hands the world is able to produce and exchange goods and services in greatly increased abundance. This improvement in productive power has everywhere outrun by a long way the growth of population. It

has been a real development of the productive value of almost every kind of human labour by hand or brain. Obviously such progress in productive capacity ought to be clear gain. It ought to enable the world to live at a greatly improved standard of life and at the same time to enjoy a more abundant leisure. It ought to have taken us in every country, not excepting the countries of the Far East, a long way towards solving the problem of poverty. It ought to have made the economic problems of society far less pressing and released a great deal of man's energy for the cultivation of the less "dismal" arts of life. It should have made the whole world richer, healthier, happier, more intelligent and more confident about the future. For there is every reason to suppose that with the aid of science productive power can—if we organise it aright—be made to advance in the next twenty years even faster than in the last. I ought to be writing a book, not about the world depression or the danger of a world crisis, but about the best uses of the world's new found wealth and opportunities for leisure. We ought all to be spending our time learning how to make the most of a higher standard of life, instead of queuing up at the employment exchange or the soup kitchen or writing dismal books about the dismal economic outlook.

The Curse of Plenty. Instead of that, what do we find? That of most of the leading foodstuffs and raw materials there are large stocks accumulated for which no buyers can be found at a remunerative price. This is not because the goods are not needed, for the world has need not merely of all that it has produced but of all the things it could have produced but has not produced for fear of glutting the market further. The trouble is not that the goods are not required but that the people who need them cannot afford to buy them. Meanwhile, in the manufacturing regions of the world there is indeed no similar glut of goods, for the manufacturer is not driven to pile up stocks in the same way as the primary producer, but there is instead widespread

unemployment. Millions of men and women can find no work, and thousands of factories are standing idle because those who control them can find no means of selling their products at a profit. The world stands aghast at its own productive power, and the more this power increases, the less, apparently, is the world able to make use of it. No one even attempts to deny that this situation is at once ludicrous and tragic. Of what use is it that scientists should devise means of making human labour more productive, if the result is to be that the increase of productive power becomes a positive cause of unemployment and distress? Of what use is it to devise machines for the lightening of labour, if these machines will only throw more and more people out of work and income? And what are we to say of a world in which the farmer, when he sows his crop, has to pray for a bad harvest in order to rescue him from his financial difficulties? We live in an odd world and no mistake.

Of course it may be answered that abundance is not the *cause* of our troubles, and that the fault is not in the bounty of nature or in the achievements of science but in our failure so to organise as to take proper advantage of these indisputable benefits. Of course that is perfectly true. It cannot be bad for harvests to be abundant or for workers to produce more. On the contrary it must be positively good, and there must be means, if we will but adopt them, of making this abundance the means to a higher standard of living for all. The fault is not in man's productive skill or in the plenty of goods, but somewhere in the organisation of the economic system. So far I am merely stating obvious truths which no one can possibly dispute. Everyone agrees that there is something seriously wrong with the management or lack of management of the world's economic affairs, but as soon as we ask where the fault lies we pass out of the realm of certainty into that of sharply divergent opinions. How deeply rooted is the cause of the trouble? Can it be cured by some single reform such as the improved organisation of the world's monetary system, a revision of tariff policies, a universal cancellation or scaling down of debts, both internal

and external, a real advance towards disarmament and pacific settlement of international difficulties, or by any other change consistent with the retention of the present economic system ? Or must we try some far more radical cure, or even follow the example of Russia, with her dictatorial Communist regime and her Five Year Plan, and endeavour to extend Socialist economic planning from a national to a world-wide scale ?

Obviously these questions cannot be answered at the present stage, nor can we hope at all to get answers that will command universal assent. Before we even attempt to answer any of them we must survey the facts and try to find out how the world fell into the present crisis and what are the tendencies making for recovery or for further prostration.

I shall go on therefore in the next chapter to a description of the world-slump—its origins, its successive phases and its reactions on the various countries and sections of the world's population. This will be only a preliminary survey designed to bring the character of the problems with which this book has to deal into clear relief. We shall find in this preliminary survey of the world slump that, in order to make it intelligible, we have to go back, first of all to the history of the eleven years between the ending of the World War and the onset of the slump itself, and then further still not only to the conditions which existed during the war but also to the economic system as it was in the pre-war world and as it grew up in the course of the nineteenth century. We shall have to study, at least in outline, the rise of the great nations and imperialist powers whose rivalries came to a head in the World War and to watch the economic effect of the gradual spread of modern methods of power production from country to country over a large part of the civilised world. That done, we shall be in a position to return to the facts and tendencies of to-day and to pass judgment on the various explanations of the slump and the various remedies which have found favour among politicians and economists of different schools.

Overproduction Impossible. But above all, before coming to the description of the slump itself or even beginning to discuss its causes I have aimed in this chapter at stressing the utter absurdity of the world's economic plight and at emphasising the contrast between the actual achievements of the economic system and the ends which a reasonable economic system ought to have in view. The sole end of all economic activity, as we have seen, is the promotion of human happiness, primarily by securing the largest possible production of wealth that is consistent with men's demands for leisure and reasonable conditions of work, and for the best possible distribution of the wealth produced. These are the standards by which it is necessary to judge the success or failure of any economic system, and throughout this book we must keep these standards steadily in mind.

We can therefore rule out of court at once anyone who argues that the world is really producing too much or that we ought simply to bear our troubles as a visitation from Providence without attempting to find a constructive remedy. For the economic system is something made by man and capable of being remade in order to serve man's needs. As long as there remain clamant human needs unsatisfied, it must be desirable for the world to increase both its productive power and its actual production ; and failure to make full use of the productive resources at our command must be due to folly and mismanagement and must be remediable if man will but apply enough intelligence to finding the remedy. Not to believe this is sheer despair of human reasonableness and commonsense, and involves a conviction that in very truth mankind is mad. The events of the last twenty years may indeed seem to afford plain evidence of man's collective folly and incapacity ; and there is no need to deny that the task of finding the right ways of organising on a world-wide scale the enormous productive resources at man's call is difficult and demands all the brains and all the good-will that can be summoned to the service of humanity. But the difficulty

of the task is a reason not for despair but for intenser effort and the moral of past follies is that the appeal to human reasonableness must be made on a more extensive scale. For mankind gets the leaders it deserves ; and it is by this time plain that the nations will only succeed in arranging their economic affairs aright if there is a widely diffused understanding of economic problems and an intelligent public opinion capable both of backing up the leaders when they do the right thing and discarding them remorselessly when they do wrong. The technicians and the workers in industry are standing by, ready to do their job of producing wealth in far greater abundance, but the nations of the world are not yet organised so as to accept their services. In these circumstances it is necessary to summon all hands to the task of setting our economic system in order. For man clearly must not rest content until he has created an economic order equipped to distribute all the goods that his command over nature enables him to produce.

CHAPTER II: THE ECONOMIC CONSEQUENCES OF THE WAR

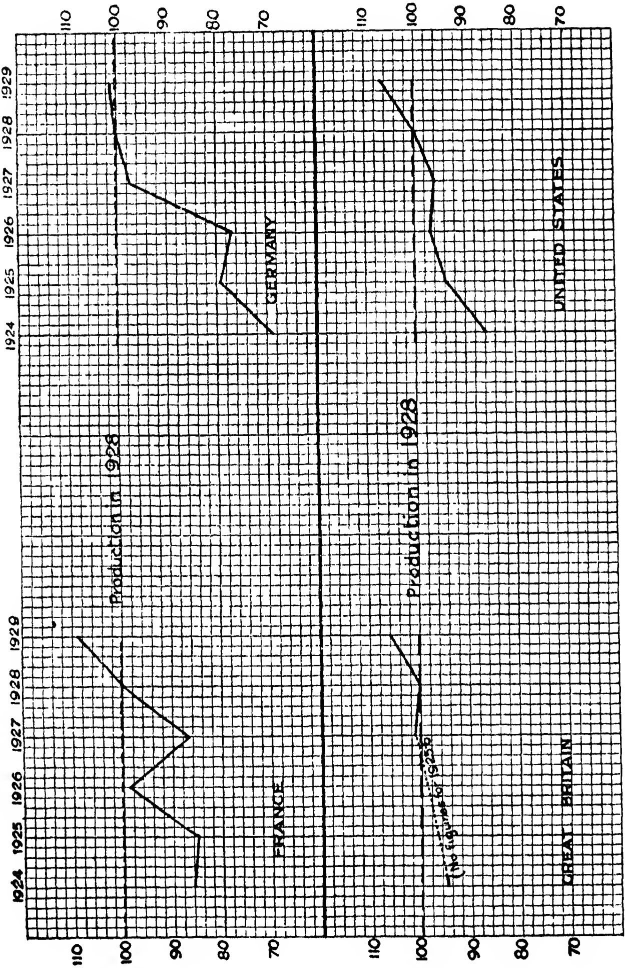
1. The World before and after the Slump
2. The United States
3. The Slump in Europe
4. The Crisis in Great Britain
5. Debts and Reparations

§1. THE WORLD BEFORE AND AFTER THE SLUMP

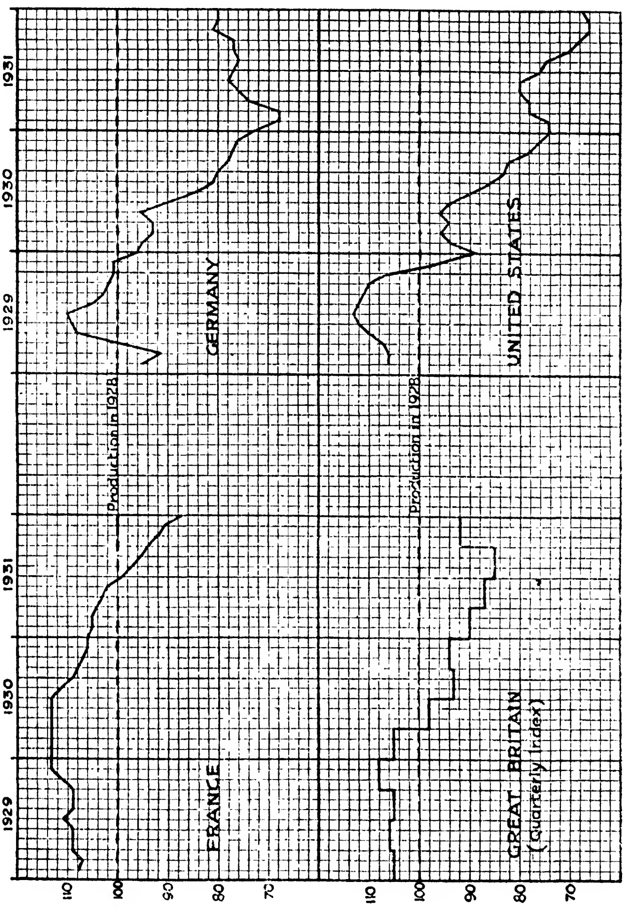
IN THE course of the years 1928 and 1929 the world as a whole attained to a new record level of economic activity. Almost everywhere the production, not only of foodstuffs and raw materials, but also of manufactured goods, was higher than ever before, and there was also a larger amount of economic activity being applied to the rendering of every kind of service. In the world as a whole the standard of living was probably higher than it had ever been; and yet even at the height of the boom in 1929 far less than full use was being made of the available powers of production. There was much unemployment in the world even then; and there were many idle factories and many inventions which were being but slowly applied. Still, on the whole in 1928 and 1929 there seemed to be ground for the optimistic view that the world was almost at an end of its post-war economic difficulties, and that it was about to take a great leap forward towards a higher standard of living.

Then in the course of the years 1929 and 1930 the situation dramatically changed. The Wall Street collapse in the autumn of 1929 was the first overt sign that the boom was at an end; and from the United States depression spread rapidly and with increasing force to one country after

THE DEVELOPMENT OF PRODUCTION BEFORE THE WORLD SLUMP
(Annual Indices)



THE FALL IN PRODUCTION DURING THE WORLD SLUMP
(Monthly Indices)



another. We are still in the trough of that prodigious depression. Indeed by now we have almost got used to it, and the shock of finding our illusions of a few years ago destroyed has begun to wear off. We are far enough from the collapse of 1929-30 to begin to take intelligent stock of its causes, and we have suffered from the depression long enough to have grown sceptical of those who tell us that it is only one of the familiar cyclical movements of trade, and that recovery and boom are bound to succeed in due course to depression, even if humanity takes no remedial action to bring them about.

In this chapter we have to enquire first what the depression is, secondly how it arose, and thirdly what have been its main successive phases and how, and to what extent, the chief events have reacted on one another. We have to see how the slump has affected this or that trade or class or country, and we have to ask how far the attempts of various countries to relieve it or to escape from its consequences have actually made it better or worse. Finally we have to try and find out whether it is still deepening or at best continuing without sign of relief, or whether there are prospects of its passing away. These are in the main questions of fact, although they cannot all be answered in terms that will command universal assent. For if we could all agree both about the facts and about their explanation we should have little difficulty about agreeing upon the appropriate remedies.

Inevitably there will be disagreement about the facts, for men see facts differently according to their various interests and preconceptions. It is therefore important to make plain at the outset from what angle the problem is being approached. The author of this book happens to be an Englishman, and naturally he writes with events in Great Britain very prominently in his mind ; but he is very conscious that if he writes as an Englishman and from a British angle of vision there will be no hope at all of stating the facts, and much less the causes, of the crisis rightly or in the right perspective. For the crisis through which we are passing is

above all others a world crisis affecting every continent and every country, and it must be surveyed from an international standpoint if its events are to be seen in their true proportions or their meaning correctly understood.

Citizens of the World. I shall try to write, therefore, from the standpoint of a citizen of the world, or rather of one surveying world affairs from the angle of no particular country. And I am the more intent upon doing this because this international approach is so necessary a corrective of the common man's outlook on the crisis. For naturally most of us are conscious of the crisis mainly through its effects on our own country and on ourselves ; and we are accordingly apt to look for remedies for our own troubles and for those of our own country without giving a thought to their reactions upon the rest of the world. In some degree we are bound to do this, for as the world has no effective common government in either political or economic affairs the only thing the ordinary man seems to have any hope of influencing is the policy of his own country ; but even if most of the measures taken to deal with the crisis have to be taken by national bodies, it is of vital importance that these measures should be conceived in the light of an understanding that the crisis is not national but worldwide, and that the attempts of one nation to relieve itself may react disastrously even upon itself if they are of such a kind as to bring disaster elsewhere.

Of course we all know, up to a point, that the crisis is worldwide. The difficulty is to make men realise that the remedies must be worldwide too. For most of the things that have gone wrong are of such a nature that no one country can put them right without the collaboration of the others. Think for a moment of the main incidents and features of the crisis. Hardly one of them can be described in purely national terms. The universal fall in prices, the troubles over the working of the gold standard and the fall in the value of silver, the problems of reparations and war debts and of the wider relations between debtor and creditor

countries, the rise of tariffs and import restrictions, the development of Far Eastern competition with the industries of Europe, the extraordinary vagaries of overseas investment both before and after the crisis—all these are essentially international in nature. They are all, moreover, related closely to the international political background of the Peace Treaties, which created new States and new frontiers in Europe, breaking up established economic units of production and trade and redistributing colonial empires. They are no less clearly bound up with other international legacies of the Great War—the Communist Revolution in Russia, the new scepticism about parliamentary democracy which led to the creation of dictatorships in Italy, Spain and other countries, the rapid growth of national and class unrest in India and China, and finally, the acute sense of insecurity which the disturbances of war and revolution have left behind over the whole world. All this ferment, active in the minds of men, deeply influences not only the economic policies of Governments but also the attitudes of individuals in all countries to every-day economic affairs. A lack of confidence based on a complete uncertainty about the world's future is a psychological aspect of the present crisis that can hardly be given too much importance ; for it too affects every country and influences almost every individual in his economic habits and everyday business dealings as well in his attitude to the wider problems of economic and political policy.

A bare recital of a few outstanding events of the crisis throws its worldwide character plainly into relief. It opens with the great boom and the great slump concentrated upon the stock markets of the United States. It passes over into the growing difficulties of the great agricultural countries in North and South America and in Australasia. It spreads through Germany and Central Europe with the withdrawal of the American investor from Europe and with consequent financial stringency which culminated in the collapse of the Anstalt Bank in Austria and the Danat Bank in Germany. It provokes next a world "crisis of

confidence" which throws Great Britain and a number of other countries off the Gold Standard, compels the United States to initiate a moratorium for international debt payments, causes Great Britain to abandon her traditional devotion to Free Trade, and involves in almost every country a positive zariba of government restrictions and controls impeding the free movement of goods and still more of money to pay for goods.

The Spread of Desolation. It is obvious that in their far-flung consequences of disaster the troubles of each country have only served to worsen the position of others. The crash in the United States reacted directly on Great Britain and Germany, and on every country which relied on the United States as a market for its goods. Germany's financial difficulties seriously embarrassed Austria and the whole of Central Europe, and reacted dangerously on the financial situation in both Great Britain and the United States. Great Britain's departure from the Gold Standard threatened the export trade of every country that remained upon it. Moreover, everywhere the measures taken by each country in order to protect itself reacted unfavourably on its neighbours and caused them to take corresponding measures by way of retaliation. Rising tariffs and restrictions on imports, on foreign exchange and on the movement of capital from one country to another interfered with the normal exchange of goods for goods, and involved restriction of output on both sides of each tariff frontier. In all the money-markets of the world money got locked up; and credit, without which trade and industry cannot, under modern conditions, exist, was in danger of being brought to a complete stand. Governments, faced with a contraction in revenue in consequence of the depression, were driven to economise even on the most necessary forms of public expenditure, and their economies further restricted the demand for goods and services. Wage reductions in one country led to competitive reductions in others in the course of a scramble to reduce costs in order to retain as large a

share as possible in a constantly dwindling world market. But wage reductions reduced demand still further and so increased the total volume of world unemployment and placed on embarrassed Governments the fresh burdens of the maintenance of the unemployed. The distress spread in ever widening circles within each national economic system ; and every national measure designed to deal with the emergency threatened to create a fresh emergency elsewhere.

In these circumstances the crisis as it arose in each particular country is unintelligible except in relation to its incidence on other countries. We may, indeed, reach the conclusion that certain countries had a far larger share than others in bringing it about. But in describing it the essential thing is to look at it not from the angle of any particular country, but rather as it would appear, say, to one of the Spirits in Thomas Hardy's *Dynasts*, surveying human affairs as aloofly as a man can look at an anthill. Or rather with this difference—that the spectacle is one not of ceaseless motion and even apparently purposeful activity, but rather of a gradual slowing down and paralysis of life that strikes mines and factories idle, bids ships cease plying over the ocean, and leaves heaped up stores of cotton and wheat, of rubber and even of gold lying useless here and there about the world, while in China millions starve, and in every country men, women and children go shorter of the very things which the idle workers and the idle factories, could they but use these stores of raw produce, are equipped to create in ever increasing abundance. We have seen in the previous chapter that, for some years before the great slump set in, world production had been rising fast—much faster than population—and that nowhere had this recovery from post-war depression been more remarkable than in Europe. Europe's production of foodstuffs and raw materials rose by 17% between 1925 and 1929 as against 11% for the world as a whole, and over the same period the estimated volume of European foreign trade rose by 22% and that of the world as a whole by 19%. Over the same four years

PRODUCTION OF CERTAIN COMMODITIES IN THE LEADING COUNTRIES, 1929

	Wheat	Coal	Petroleum	Electricity	Steel	Motor Car	Ships	Cotton	Livestock		
	Millions of Quintals Average	Millions of Metric Tons	Millions of Metric Tons	Millions of KWH	Millions of Metric Tons	Numbers Produced Thousands	Steam and Motor Thousands of Gross Tons Launched	Mill Consumption Thousands of Metric Tons	Cattle Millions	Sheep Millions	Pigs Millions
	1928–30	1929	1929	1929	1929	1929	1929	1929–30	1929	1929	1929
U.S.A.	234	552	138	97,352	57·3	5,358	112	1,386	58	51	53
Great Britain	13	262	—	17,392	9·8	239	1,520	574	8	24	3
Germany	37	163 174†	—	30,661	16.2	135	249	295	18	3	20
France	76	54	—	14,327	9·7	250	79	268	16	10	6
Italy	63	—	—	9,794	2.1	91	71	221	7	10	3
Canada	115	12	—	17,663	1·4	263	—	47	9	4	4
Argentine	68	—	1	829	—	—	—	—	32	44	4
Australia	44	11	—	2,286	0.4	—	—	—	11	106	—
Japan	—	34	—	12,036	2.3	—	165	604	1	—	1
India	90	24	1	—	0.6	—	—	447	147	36	—
China	—	15	—	2,124	—	—	9	465	—	—	—
U.S.S.R.	233	38	14	6,465	4·7	—	34	442	67	133	21
World	1249	1327	206	—	120.5	6,367*	2,774	5,434	—	—	—

† Lignite. * Leading countries only.

industrial production also made a rapid advance—at least equivalent to the rise in the production of foodstuffs and raw materials.

§2. THE UNITED STATES

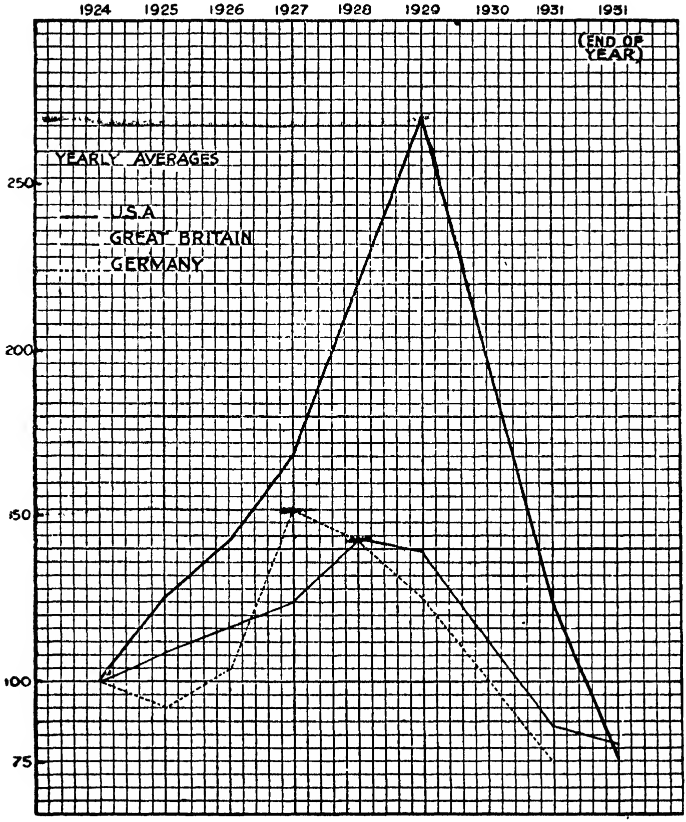
EUROPE'S advance had been, indeed, more regular than that of the United States, where the boom of 1928-9 was marked by a very different rate of advance in different parts of the economic system. The American boom was primarily a boom on the stock markets, in real estate, and in the constructional industries. It was much less a boom in either wages or employment, or in real consumers' demand. But these signs of a discrepancy in the rate of advance were little heeded, and up to the stock market crash American opinion was almost unanimously full of overweening confidence in the advance of prosperity. High profits were being made in almost all industries, and the investment of capital was proceeding at a furious pace. There was intense activity in all the constructional trades, and new factories, houses and palatial blocks of offices were being erected at an astonishing rate. In anticipation of the continuance of prosperity land regarded as ripe for development was changing hands at enormous prices, while the values of industrial shares on the stock markets were being pushed up out of all proportion to their current yield in actual profits. Investors were putting their money optimistically on the future ; and speculators, taking a shorter view, were reaping an abundant harvest out of the credulity of the public. From Americans of all classes and also from foreigners all over the world money was being poured into the American stock markets by owners eager to share in the rich rewards that were to be had for the asking. For as stock prices rose higher and higher no one who went on buying could help reaping an extravagant paper profit. Dividends almost ceased to count ; for what mattered was

capital appreciation, which grew greater and greater as more and more money was drawn into the vortex. Credit expanded by leaps and bounds ; and the attempt to prevent its use for speculative purposes hopelessly broke down. Meanwhile gold was drifting away from other countries and piling up uselessly in the United States, as more and more foreigners transferred their liquid resources from other centres to New York.

Between 1924 and 1929 the average value of common industrial stocks in the United States went up by over 200 %, whereas in Great Britain and Germany the corresponding increase in stock values was only in the neighbourhood of 25 %.

This enormous inflation of stock prices was never justified on any reasonable anticipation of actual business earnings. It could not have been justified even if industry had remained prosperous. It was for the most part sheer speculation, by which sooner or later someone was bound to lose. The speculator who went in to look for purely short-term gains might of course realise a vast fortune if he cleared out in time ; but there was bound at some stage to come a realisation that stocks and shares were ridiculously overvalued, and as soon as the consciousness of this did dawn upon the public someone was bound to be left "holding the baby." Through the greater part of 1929, however, the short-term forces making for the continued rise in stock values were too strong for the voice of reason to be heard. Banks continued to make advances on securities at valuations based on the inflated prices of the boom. Speculators continued to gamble instead of getting out while the going was good ; and consequently stock prices went on rising long after, looking back now, we can see that the conditions of impending collapse had already become manifest.

Signs of Trouble. Indeed, to anyone who was looking further ahead than the gamblers on the New York stock market and watching the signs of the times, there were, in 1929, plenty of indications of disequilibrium in the American



MOVEMENT OF SHARE PRICES

IN UNITED STATES, GREAT BRITAIN AND GERMANY, 1924–1931

(Yearly Average Values of Common Industrial Shares)

MOVEMENT OF SHARE PRICES BEFORE AND AFTER THE SLUMP

Prices of Ordinary Industrial Shares, or Common Stocks.

1924=100

		United States*	Germany	Great Britain†
1924	(average of year)	100	100	100
1925	„	126	92	109
1926	„	143	105	115
1927	„	169	152	124
1928	„	220	141	142
1929	„	270	125	139
1930	„	201	100	112
1931	„	124	75 (to June)	87
1931	(end of year)	77	Stock Exchange closed	81

* The United States index stood at 309 in September 1929 just before the crash, and fell to 207 in November 1929. It revived to 244 in April 1930, and fell sharply to 146 at the end of the year.

† The British index stood at 78 in August 1931, just before the suspension of the gold standard. After the suspension it rose to 92 in November 1931, and then dropped to 81 in December.

economic system. America is a great agricultural as well as a great industrial country; and the boom in the constructional industries and in the stock markets was by no means reflected in the condition of the farmers. For while in general the levels of both wholesale and retail prices in the United States were practically stable from 1927 to 1929, although over the same period prices in other countries were tending to fall, this was not true of American agricultural prices, which were falling both absolutely and in relation to the prices of industrial goods. The American farmer found himself compelled to sell his produce at falling prices based on world conditions, whereas he had to buy his supplies at the higher prices current in the home market. Already in 1928 the prices of farm products in the United States were only 39 % above the pre-war level, whereas prices of the supplies purchased by farmers were 56% above.

This situation, which was due in part to the deliberate policy of the American banking system in stabilising the domestic price level and in part to the growth of speculative activity and the inrush of money into the United States, placed the farmer at a serious disadvantage and united with the growing rationalisation of agriculture to cause a large movement of labour in search of employment from the country to the towns.

Rationalisation and Unemployment. In American industry, however, rationalisation was proceeding at least as fast as in agriculture, and despite the increase in total industrial output the volume of employment was actually lower in 1929 than in 1926. The workers who flowed into the towns from the country districts therefore found no jobs awaiting them, and at the height of the American boom there was in the United States a volume of unemployment already estimated, as we have seen, at over two millions. Moreover, even those workers in the United States who remained in full employment got little advantage from the boom. The great increase in paper prosperity went mainly

to investors and speculators, and very little of it found its way to the main body of the American working class. Average weekly earnings of wage-earners were actually no higher in 1929 than in 1926. Inevitably this failure of earnings and employment to keep pace with the advance of production set up a disorder in American economic life ; for the increased productive resources that were being brought into operation could not be used profitably unless the demand for goods expanded at a sufficient rate to absorb the increase. For a time the rapid development of instalment purchase helped to keep up the level of consumers' demand despite the lag in wages. But the high level of profits and the growth of rationalisation combined to cause productive power to expand too fast for consumers' demand to keep pace with it. The American people, taken as a whole, tried to invest too much and to spend too little on consumers' goods, and in the long run this lack of balance was bound to lead to the collapse of the boom. For even if the new mines and factories succeeded in selling their products at a profit owing to their greater efficiency, their success, in face of the restricted total of consumers' demand, could only lead to more and more failures and bankruptcies among the older and less efficient productive concerns ; for savings invested in industry can only realise their purpose if consumers' demand expands fast enough to absorb the goods which the new and old factories together are able to produce.

It may be suggested that the Americans could have restored the balance of their economic system by increasing their exports. But there were several reasons why this could not be done. In the first place prices in America were high in relation to prices in the rest of the world, largely because, as we have seen, the American banking system had aimed at keeping the price level stable despite falling costs of production at a time when prices in the rest of the world were tending to fall. Secondly, it must not be forgotten that America has been since the war a great creditor nation. Now a creditor nation must import more than it exports unless it is prepared to lend to other countries the means of

buying its goods. Up to 1928 the Americans were lending their money abroad on a very large scale by the export of capital to South America and to Europe—above all to Germany where the movement for rationalisation was financed largely with American money. But in the Wall Street boom of 1928-29 the prospects of profit from investment and speculation were far greater in the United States than anywhere else in the world. Accordingly Americans preferred to keep their money at home ; and foreign capital also rushed in to get its share in the inflated profits of stock speculation. Under these conditions it was out of the question for foreigners to buy more goods from the United States. They had to buy less—both on account of the contraction in American lending and to offset the export of their own money to New York.

The American boom of 1928-29 was in these circumstances inherently unstable. It may seem paradoxical to suggest that the chief cause of the slump in the United States was that wages there were too low, for were not American wages the highest in the world? But the right level of wages in a country depends on the level of productivity, and there is no doubt at all that the American wage bill was lagging far behind the growth of American productive capacity—partly because wage rates rose too little, and partly because rationalisation was causing the volume of employment in both industry and agriculture to become less. Add to these factors the fall in the purchasing power of the farming community, who still form a very large element in the population of the United States, and it is not difficult to see why the boom collapsed and gave place to a depression which spread rapidly over the rest of the world. For if the purchasing power of the American public once fell off, this was bound to react disastrously on all those countries which looked to America as one of the principal markets for their own products.

The contraction in industry had indeed begun some time before the speculators on the stock market became aware of it. Even while the prices of securities were still booming in

New York, industrialists in the United States were finding more and more difficulty in selling their goods and were beginning to curtail production. Stocks of raw materials and foodstuffs were piling up and being held off the market for fear of bringing down prices ; and the volume of employment was falling fast. It was becoming evident to more and more people that the existing high levels of profits could no longer be maintained, and the prudent were already beginning to withdraw their resources from the stock market as they realised that Wall Street had been capitalising in advance the rapidly rising productivity of industry, on the assumption that there would be a correspondingly swift expansion in demand. As soon as enough people came to realise that there was no warrant for this expectation the entire speculative edifice collapsed like a house of cards.

Accordingly, in the Wall Street panic of September 1929 there was a sensational destruction of inflated paper values, and by the end of the year the average prices of industrial stocks had gone down by nearly one third. In the early months of 1930 there was a brief, partial and illusory recovery ; but thereafter the fall was resumed. At the end of 1930 stock prices had been halved since the boom and were back at the level of 1926, and in 1931 they continued headlong on their downward course—falling by the end of the year to little more than one half of their value at the beginning of it, and to less than one third of the 1929 prices.

§ 3. THE SLUMP IN EUROPE

FOR THE present, however, we are concerned, not with following the course of the slump in the United States, but with the repercussions of the American boom and slump on the rest of the world. For the boom as well as the slump produced disastrous reactions elsewhere. As the speculative fever developed in the United States the flow of American capital overseas ceased abruptly, and a reverse movement of

European capital to America set in. This loss of resources, combined with the necessity of paying the United States interest both on war loans and on heavy post-war borrowings, caused a rise in bank rates and a restrictive credit policy throughout Europe. It forced European prices down and increased European unemployment. The gold which had been released from America during the period of large overseas investment began to silt up again in the American banking system, leaving the European Central Banks with a short supply. But while European prices were forced down by the restriction of credit, the fall in the volume of production and the rise in interest rates actually caused the costs of production in Europe to increase.

The Troubles of Germany. This was bad enough, but on one country in Europe the reaction of the American boom fell far more disastrously than on the rest. Germany, since the stabilisation of her currency and the readjustment of reparations under the Dawes Plan of 1924, had been energetically reconstructing her industries on the basis of an intensive mechanisation which involved very heavy capital expenditure. As Germany had lost nearly all her working capital during the previous period of inflation of the mark, this capital expenditure could be incurred and reparations could be paid only out of foreign loans ; and in fact between 1924 and 1928 Germany borrowed from abroad and above all from the United States far more than she paid in reparations. During these years the Germans borrowed from investors in other countries nearly fifteen thousand million reichsmarks (£750,000,000 at par). This was twice as much as she paid in reparations including deliveries in kind, and at least half of her total borrowings came from the United States. Without these loans reparations could not have been paid and German industry could not have been rationalised. Germany, in fact, depended on heavy borrowing from overseas to make her economic system—shattered as it had been by war and inflation—balance at all.

In 1929, owing to the boom in the United States, American investment in Germany suddenly fell off, and the Germans were faced with economic disaster unless they could find an alternative source of funds. The sums they had borrowed from the United States had been mostly long-term loans to German industries, public services and municipal bodies. But after the withdrawal of the Americans there was no long-term capital to be had, and the gap had to be filled up, as far as it could be filled at all, mostly with short-term credits borrowed from abroad through the German banks. British, Dutch, Swiss and other bankers lent the Germans, at high rates of interest, just enough short-term money to enable them to carry on ; but the Germans had also to take special measures in order to reduce their imports, and had to embark on an intensive campaign for the expansion of their exports in order to make their account balance. In face of these changed conditions the volume of employment and the standard of living in Germany began to fall, and the German economic system was placed in the highly perilous position of using credits borrowed only on short-term conditions, and therefore repayable at the will of the lenders, for purposes which involved locking the money up over a long period.

When in the United States the boom broke and the slump set in, the situation of Germany at once became far worse. There was no revival of American overseas investment ; for American investors, thoroughly scared by the stock market collapse and full of uncertainty about the future, were in no mood to risk their money. Moreover, many of the American banks were in serious trouble through either buying or making large advances upon securities which had slumped heavily in value ; and these banks were intent on recalling funds from abroad in order to meet their difficulties at home. This recall of American money reacted both on Germany's power of borrowing from America direct and on the willingness of other countries to lend. For the American banks were recalling funds from other centres as well, and the money which European financiers had been lending to

THE MOVEMENT OF CAPITAL (MILLIONS OF DOLLARS) LONG AND SHORT TERM

Lending Countries—Exports.	1923	1924	1925	1926	1927	1928	1929	1930
U.S.A. . . .	−126	489	622	140	470	1036	233	547
Great Britain . .	700	380	261	−29	482	667	672	190
France . . .	—	—	—	—	504	235	−29	−234
Canada . . .	44	107	277	173	51	164	−87	−161

(a minus sign above shows imports of capital)

Borrowing Countries—Imports.	1923	1924	1925	1926	1927	1928	1929	1930
Germany . . .	—	421	866	169	1090	1017	567	145
Australia . . .	187	220	110	170	257	193	166	187
Argentine . . .	32	170		31	134	131	38	—
Japan . . .	—	226	74	128	22	54	−25	—

(a minus sign above shows exports of capital)

Note.—As the above table shows short-term as well as longt-term capital movements, it fails to reveal either the continued contraction of American long-term foreign investment in 1930 or the full extent of the fall of long-term investment in Germany in 1929, when the Germans were driven to short-term borrowing as the supplies of long-term loans dried up. The heavy French capital movement of 1927 was also mainly of short-term money.

GERMANY'S FOREIGN DEBTS

A. *German borrowing from Abroad* (in milliards of Reichsmarks).

Total at end of	1926	1927	1928	1929	1930	July 1931
Long-Term	4·1	5·4	7·0	7·3	9·2	9·0
Short-Term	4·1	6.6	9·0	11·7	10·3	8·0
Other and undefined	3·5	4·5	5·5	6.0	6.0	6.0
TOTAL	11·7	16·5	21·5	25·0	25·5	23·0

B. *German lending Abroad*

	1926	1927	1928	1929	1930	July 1931
Long-Term	4·5	4·5	4·5	4·5	4·4	5·0
Short-Term	3·6	3·9	4·5	5·5	5·3	3·5
TOTAL	8·1	8·4	9·0	10·0	9·7	8·5

	1926	1927	1928	1929	1930	July 1931
C. *Germany's Net Indebtedness*	3·6	8·1	12·5	15·0	15·8	14·5

GERMAN BALANCE OF TRADE

(in milliards of Reichsmarks)

	1924	1928	1930
Excess of Imports over Exports of Goods	1.8	1.3	—
Excess of Exports over Imports of Goods	—	—	+1.5
Excess of Imports over Exports of Gold and Devisen	1.3	0.9	—
Excess of Exports over Imports of Gold and Devisen	—	—	+0.1
Reparation Payments	0.3	2.0	−1.7
Net Revenue from Shipping and Services	+0.3	+0.5	+0.2
Net Revenue from Foreign Investments	+0.2	+0.6	−0.8
TOTAL DEFICIT	2.9	4.3	0.7

GERMANY'S FOREIGN TRADE, 1927-1931

(in millions of Reichsmarks)

Monthly Averages

	Net Imports	Net Exports	Net Balance
1927	1186	852	−334
1928	1167	968	−199
1929	1121	1055	−66
1930	866	944	+78
1931	561	767	+206

Note.—(*a*) the gradual reduction in the adverse balance of merchandise trade, even in the earlier years when Germany was still importing capital from abroad ; (*b*) the sharp fall in imports after 1929, due partly to the fall in prices, but also to curtailment of imports in order to build up a balance for payment of debts and reparations ; (*c*) the signs of an intensive effort to maintain exports in face of the world slump.

GERMANY'S BALANCE OF PAYMENTS, 1931

(Estimated by the Young Plan Advisory Committee)

in millions of Reichsmarks

Export Surplus (including services and deliveries in kind)	3,000	Reparations to June 30	800
Utilisation of Foreign Assets of German Banks	1,300	Interest and Sinking Fund on Foreign Debts	1,500
Foreign Credits (including Central Banks and Bank for International Settlements	1,200	Foreign Capital withdrawn	4,900
Gold, etc., from *Reichsbank* Reserve	1,700		
	7,200		7,200

the Germans was, in fact, to a considerable extent, American short-term money.

Thus through the whole of 1930 and 1931 the German economic position became steadily more difficult and even desperate, although the German Government took the most drastic measures to deal with the situation. Imports were cut down ruthlessly at the expense of the standard of living among the German people, while in the effort to expand sales export prices were greatly reduced to the consternation of Germany's leading competitors in the world market. The German producer, compelled to cut his prices in order to improve his position in foreign markets, tried to recompense himself by selling in the German home market at a higher price, and this reacted further on the German standard of living. The rationalisation of German industry had been carried through on the assumption of expanding world demand ; and the rationalised German industries could produce at low cost only if they were able to market a very large quantity of goods. For it is in the nature of rationalisation to make the most of the economies of large-scale production ; and this means that costs are low when plants are fully employed but tend to be high if anything interrupts the continuous output of the rationalised factory on the maximum scale. Rationalisation decreases labour costs and employment per unit of output ; but it increases capital costs and the interest burdens arising therefrom. These latter costs, high in the aggregate, can be kept low for each unit of output if they can be spread over the full output of which the factory is capable. But rationalisation is uneconomic unless this can be done, as the Germans discovered to their cost when the world market began, after the American collapse, seriously to contract.

The "Hoover" Moratorium. Nevertheless, in face of falling world trade, the Germans did succeed in building up a large balance of exports over imports, and thus began for the first time to pay reparations out of their own resources. But they did this only by the drastic cutting of

prices, and in the meantime, owing to the intense depression in the German home market, unemployment in Germany grew worse and worse, and a large part of the new plant of the rationalised industries stood idle. The cost of maintaining the unemployed weighed more and more heavily on the German budget, and in the early months of 1931 Germany was absolutely at the end of her tether. Only the Hoover moratorium on war debts and reparations and the Berlin "stand-still" agreement, under which Germany's creditors agreed to postpone repayment of their short-term loans, saved her from complete economic collapse; and as both these measures were purely temporary, whereas the causes which had made them necessary showed no sign of passing away, all that was secured by them was a brief respite. There was no restoration of confidence in the future, because no one knew what was to happen when the moratorium and the "standstill" came to an end. There was no recovery of the German home market or of the standard of life, which indeed was pressed down further and further as the world situation became progressively worse. Germany carried on, but only by desperate measures of semi-starvation enforced by rigid governmental control at the cost of stirring up among the German people a ferment of resentment and despair. Hitlerism and Communism alike gained converts at the expense of the middle parties as the desolation continued and the hope grew dimmer of any effective action by the creditor countries to set the situation right.

Even as matters were the value of the moratorium was partly destroyed by the difficulties which arose over its acceptance. Great Britain, though directly a loser by it, accepted immediately; but there was considerable delay before French endorsement could be secured, and in order to get this modifications had to be made in the form of the proposal. Under the Young Plan governing the payment of reparations, the sum to be paid by Germany each year was divided into two parts—an unconditional annuity payable under all circumstances and a conditional annuity payment of which could be postponed on the application

of the Germans if there was danger of upsetting the stability of the German foreign exchanges. The French took strong objection to any moratorium on the unconditional part of the annuity, of which they were due to receive the largest share ; and they were finally brought to accept the moratorium only when it had been agreed that this sum should be paid by the Germans into the Bank for International Settlements and then at once re-lent by the Bank to the German railways in order to avoid the difficulty of taking the money out of the country. On this basis the moratorium was at length accepted, but not before the delay had afforded an opportunity for considerable withdrawals of short-term capital from Germany, which was thus threatened with immediate collapse in spite of suspension of the Young annuities. The " standstill " agreement between the German banks and their foreign creditors, designed to check these withdrawals, followed hard upon the moratorium and was effective in stopping the rot. For the time being these measures sufficed to prevent a total collapse of the German economic system ; but even this was only made possible with the aid of simultaneous measures by the German Government drastically restricting both imports of foreign goods and the export of funds, at the cost of a disastrous further fall in the standard of life of the German people.

Obviously the breathing space afforded by the Hoover moratorium and the " standstill " agreement ought at once to have been used as an opportunity for a thorough reconsideration of the entire question of war debts and reparations ; for no sensible person supposed either that Germany would be in a position to resume the payment of reparations when the moratorium expired in 1932 or that, failing this, the Allied countries would be able to keep up their war debt payments to the United States. Nevertheless month after month was allowed to pass without any attempt to secure a definitive settlement of the problem. At the end of 1931 Germany applied, under the conditions laid down by the Young Plan, for a revision of her obligations and an Allied Committee produced a report on the situation

which not only affirmed Germany's inability to pay but also hinted strongly at the necessity for a drastic reconsideration of the whole problem. Following upon this report, the " standstill " agreement relating to private German debts was renewed ; but the Governments of the Allied countries still failed to reach any agreement on the reparations question. The proposed Lausanne Conference was adjourned month after month because of the failure of the French and British Governments to reach agreement. The British insisted on the need for a definitive settlement involving the complete cancellation of both reparations and war debts ; but the French, who are considerable net creditors, would still have none of this. The German Government, largely owing to an indiscreet leakage of information, was compelled by the pressure of German public opinion to announce its inability to resume payment of reparations not only in 1932 but at any time in the future ; and this announcement reacted unfavourably on French opinion. Meanwhile the Americans, although the wiser heads among them knew that it was impossible for Europe to pay, were driven by the pressure of their own public opinion to affirm that no connection at all could be recognised between war debts and reparations, and no proposal entertained for the scaling down of European debts to the United States. These declarations of the American Congress are not indeed to be taken very seriously ; but for the time they do effectually prevent any American participation in an agreed settlement dealing at one and the same time with both reparations and inter-Allied debts. Sooner or later, it is clear, reparations and war debts will both have to be cancelled ; but it is still very questionable whether agreement to do this will be reached in time to avert the collapse of the public finances of Europe. As I write, the Lausanne Conference has just reached a paper settlement. But this is conditional on American readiness to cancel war debts, of which there is still no sign. Yet without this it is evident that no real progress can be made.

§4. THE CRISIS IN GREAT BRITAIN

IN THE meantime the crisis, narrowly averted in Germany by the Hoover moratorium and the "standstill" agreement, had spread rapidly to other countries and especially to Great Britain. The British economic and financial system was peculiarly vulnerable because of London's pre-eminent position as a centre of world finance. The London banks and discount and acceptance houses had lent all over the world large sums for the financing of international trade; and they had been foremost in coming to Germany's rescue by continuing their short-term advances to German banks and industrialists in spite of the obvious dangers of a German collapse. London financiers, however, had not been in a position to make these large advances of short-term funds to Germany and other countries out of their own resources; for the decline in British exports and in the receipts of British capitalists on their foreign investments had considerably reduced the free resources at the disposal of London for international use. In these conditions the Bank of England seems to have set out deliberately to attract foreign money to London in the form of short-term deposits and investments by maintaining bank rate at a relatively high level, and the money lent by London financiers to other countries was largely money borrowed on these terms and accordingly liable to recall at short notice by its owners.

As the world crisis grew worse, the reactions on the London money market were proportionately severe. On the one hand it not only became impossible to withdraw money lent to the Germans but also, as world prices continued to fall and the troubles of other countries to increase, very difficult to secure repayment of short-term credits granted in other quarters, such as Australia and the South American Republics, which were alike hard hit by the exceptionally heavy fall in the prices of raw materials and foodstuffs. On the other hand, those who had lent money to London became anxious to recall it as their own domestic difficulties

increased. There was a large withdrawal of American funds from London owing principally to the troubles of the American banks in face of the falling prices of securities in New York, and the French were also actively repatriating money which they had deposited abroad during the period of inflation in France, when there had been a "flight from the franc" on a tremendous scale.

These heavy withdrawals of resources from London were bad enough in themselves, as the London financiers were unable owing to the world situation correspondingly to reduce their commitments abroad. But their effect was also cumulative; for before long their continuance began to arouse fears about the stability of the British financial system and Great Britain's power to remain upon the gold standard. As long as the gold standard was maintained by Great Britain, money deposited in London was as good as gold, for it could at any moment be changed into gold at a rate of exchange fixed within very narrow limits. But financiers abroad began to wonder how long Great Britain would be able to allow the unrestricted export of gold in face of the growing withdrawals of foreign funds.

At this point the famous May Committee on National Expenditure, which opposition pressure had induced the British Labour Government to appoint, produced its highly controversial Report commenting upon the unbalanced condition of the British Budget, chiefly on account of the fall in revenue and the heavy expenditure on the maintenance of the unemployed—both results of the world slump. It is unquestionable that this Report, designed in the minds of its signatories to enforce measures of retrenchment on the British Government, was unduly alarmist in tone and grossly exaggerated the real dangers of the situation. It was, however, loudly praised at home by the opposition press, and accepted at its face value abroad; and its immediate effect was to produce a further run on the pound. This was in part caused by further withdrawals of foreign balances from London by foreign financiers and in part by the action of those smaller countries which had been working under

GREAT BRITAIN'S BALANCE OF PAYMENTS IN RECENT YEARS

(excluding capital transactions and movements of short term money)

	1924	1928	1929	1930	1931
Excess of imports of Merchandise and Bullion	324	358	366	391	376*
Net Government Receipts from Overseas	−25	15	24	19	16
Net National Shipping Income	140	130	130	105	80
Net Income from Overseas Investment	220	270	250†	220†	165†
Net Receipts from Short-term Interest and Commissions	60	65	65	55	30
Net Receipts from other sources	15	15	15	15	10
TOTAL RECEIPTS	410	495	484	414	301
TOTAL CREDIT OR DEBIT BALANCE	+86	+137	+103	+23	−75

* Including a net export of gold of £35,000,000.

† Estimates reduced on revision.

the so-called "gold exchange" standard, and keeping a substantial part of their reserves against their domestic issues of currency and credit in the form of sterling balances instead of gold. The Central Banks of these countries, doubtful of the future stability of the pound, began rapidly to convert these balances into gold in fear of the abandonment of the gold standard by Great Britain. There were at this stage no large withdrawals of money from London by the Bank of France, which was undoubtedly anxious, owing to the magnitude of its balances in sterling, to prevent a British collapse ; but earlier French withdrawals had, as we have seen, done a good deal to bring the British crisis about.

Great Britain Turns Borrower. The Bank of England, confronted with the danger of a huge demand for the withdrawal of funds which even the entire sacrifice of its gold reserve could hardly have met, attempted to deal with the situation by emergency borrowings from the Bank of France and the Federal Reserve Bank of New York. £50,000,000 repayable in gold was borrowed in this way in July, 1931 ; but this sum soon proved to be inadequate in face of the growing withdrawal of funds, and it was within a few weeks on the point of exhaustion. The Bank of England thereupon informed the British Labour Government of its plight and announced that there were only two courses open—the suspension of the gold standard or large additional borrowing from abroad, which would only be forthcoming if the guarantee of the Government were behind it.

It is clear in retrospect that at this stage, and indeed a good deal earlier, the only sensible course for Great Britain was to suspend the gold standard and let the pound depreciate in external value, and thus to check the withdrawal of foreign funds by making it involve a serious loss for those who attempted to remove them. But the Labour Chancellor of the Exchequer, now Viscount Snowden, was an even more fanatical adherent of the gold standard than the officials of the Bank of England or the Treasury ; and

under his influence the Labour Government decided to borrow still more money in Paris and New York in a desperate effort to maintain gold payments. It was, however, at once made clear that, even with the Government's guarantee, the bankers of New York and Paris would grant further loans only on very onerous and exceptionable conditions. It was insisted, not only that steps must be taken to balance the British Budget, but also that this should be accomplished in part by reducing the amounts spent on the maintenance of the unemployed. It has indeed been denied that this condition was ever imposed by the foreign banks ; but in spite of the denials it clearly was imposed by someone, and Mr. MacDonald, the British Prime Minister, plainly admitted this in answer to a question in the House of Commons.

The attempt to impose this last condition broke up the British Labour Government ; for a majority of its members refused to agree to drastic economies at the expense of the unemployed, although they were prepared to balance the Budget in other ways. The astonishing thing is that the Labour Cabinet does not appear to have seriously considered at all the obvious alternative of going off the gold standard. Presumably Mr. Snowden's influence was so strong that his colleagues were unable even to entertain this project. In any case, Mr. Ramsay MacDonald, the Prime Minister, finding himself at loggerheads with the majority of his colleagues, had clearly made up his mind to get rid of them ; and upon their refusal to agree he presented the Government's resignation to the King. But immediately he reappeared at the head of a Coalition Government, including, with a handful of ex-Labour Ministers, the leaders of the Conservative and Liberal parties, except Mr. Lloyd George, who was at that time seriously ill.

Off the Gold Standard. The new "National" Government, instead of suspending the gold standard, at once resumed negotiations for a loan in Paris and New York and a further sum of £80,000,000 repayable at gold parity was

added to the £50,000,000 already borrowed. But the course of events in London had by this time thoroughly frightened foreign opinion; and the withdrawal of foreign money accompanied by some export of British funds continued at a rate which speedily exhausted the new loans. Almost immediately after taking office the "National" Government, which had come into power to "save the pound," found itself compelled to suspend the gold standard—a step which ought to have been taken by its predecessor months before when there was still time to check the outflow of foreign funds.

Great Britain's suspension of the gold standard immediately produced powerful reactions throughout the world. For the position of London as a world financial centre and of Great Britain as the largest free market for exports gave the status of the pound sterling a tremendous international importance. In a number of countries, especially in South America and in Australia, the gold standard had been virtually suspended some time before its collapse in Great Britain. Within a few days of the British action other countries began to follow Great Britain's example, led by the Scandinavian countries, Sweden, Norway and Denmark, which depend very greatly on the British market for the sale of their goods. In the ensuing months more and more countries were driven off gold, till at the end of 1931 only the United States, France, Belgium, Italy, Holland and Switzerland remained upon it in any real sense, though Germany also was still held to gold by the terms of the Young Plan. The gold standard thus ceased in effect to be a world standard, and came to be no more than the standard of a limited group of countries which, in consequence of remaining upon it, soon began to find their exports reduced and to experience an alarming growth of unemployment and distress.

For the effect of suspending the gold standard was that the countries which allowed their currencies to depreciate in terms of gold thereby lowered the prices charged for their exports in the markets of the countries which remained

upon the gold standard ; while the prices of exports from the gold standard countries rose correspondingly in terms of the depreciated currencies. Less dollars or francs had to be given for a pound's worth of goods as the gold value of the pound fell, and more pounds had to be given for a dollar's or a franc's worth of goods. International trade was therefore deflected from countries which remained upon gold to those which allowed the gold value of their currencies to fall. In Great Britain this was confidently reckoned upon to bring about an expansion of exports and a fall in unemployment ; and it did undoubtedly to some extent produce these results. But, the more other countries followed Great Britain's example, the more thinly the consequent benefit to British exports was spread ; and as at the same time the depression of trade over the world as a whole continued to deepen and the world market to contract, the net gain to British exporters was comparatively small. To other countries moreover the continued contraction of the American market as the slump in the United States grew worse was a source of further disaster, for it forced down still more the already " dirt cheap " prices of the raw materials and foodstuffs on which their prosperity chiefly depended.

While therefore the departure from the gold standard did bring some alleviation of the crisis in Great Britain—for it was successful in checking the withdrawal of foreign funds—its effect was certainly not to offer any prospect of an automatic recovery from the world slump. It even accentuated depression in the United States, and thereby caused world prices measured in gold to fall further still. The abandonment of the gold standard by a large number of countries was inevitable and necessary under the conditions of 1931. But the folly of those who had demanded adherence to it at all costs was equalled by the folly of those who now saw in the departure from it the end of all economic troubles.

The Plight of Germany. For one thing, the situation in Germany was made worse by the British departure from gold. Germany was under contract to pay both reparations

and commercial debts, including the interest on her huge borrowings of overseas capital, in gold or in currencies based on gold. This compelled her to remain upon the gold standard ; but she could not do this without hampering her export trade. Yet only by means of a large surplus of exports over imports could the Germans hope to make their international accounts balance, even while the payment of reparations remained in suspense. Accordingly Germany had still further to restrict her imports, and at the same time to keep up the sale of her exports in the depressed markets of the world, under the new handicap imposed by the widespread depreciation of foreign currencies. It was impossible to do this without pressing down further and further the level of German wages and at the same time keeping up German internal prices in order to "dump" exports at the lowest possible rates. These things were done to an astonishing extent ; but the result was so to depress the German home market that unemployment in Germany rose rapidly to unexampled heights.

This situation only reproduced in a more acute form that of many other countries. Australia, the Argentine, Brazil and Chile had indeed no reparations to pay, but they owed very large sums in interest and dividends on foreign capital. As exporters mainly of foodstuffs and raw materials, the prices of which had fallen far more than those of manufactured goods, they found these debts mounting up to an intolerably heavy burden in terms of actual produce ; and they were hard put to it to keep up their payments at all. They too had to restrict their imports ; and they did this by raising still higher tariff walls which were in many cases already very high, and latterly, in addition, by direct limitation or prohibition of particular kinds of imports, as well as by growingly severe restrictions on the supply through the banks of foreign money to pay for imported goods. It became harder and harder to trade at all across national frontiers even where there was still a demand for goods, because of the increasing difficulty which buyers found in making and creditors in getting payment in face

of the restrictions imposed by one Government after another on the supply of foreign exchange.

These restrictions reacted severely on the manufacturing countries, which found growing difficulty in selling their goods and became in their turn alarmed at the danger of an excess of imports. Consequently they too began to raise their tariffs higher and to limit by means of quotas and prohibitions the quantities of imports they would allow to be brought in. Each country sought to sell without buying, and aimed at replacing imports by home products without at the same time sending less of its own goods abroad. The scope of international trade grew narrower and narrower; and everywhere the result of the stranglehold on economic intercourse was seen in an alarming increase of unemployment.

To these troubles was added a sharp fall in the price of silver, which in effect halved within a few years the buying power of China; while civil war and boycott in China and civil disturbance and boycott in India contributed further to the dislocation of the world market, and reacted with special force on the old-established exporting industries of Great Britain.

It is true that the departure of Great Britain and the countries which followed her example from the gold standard eased the burdens of the debtor countries in as far as their debts were owing to creditors who had no longer to be paid in gold or its equivalent. It also reacted favourably on the silver-using areas; but these alleviations were not nearly great enough to offset the causes making for further depression, and right through the winter of 1931–32 the world as a whole continued to plunge into deeper and deeper distress.

§5. DEBTS AND REPARATIONS

MEANWHILE, as we have seen, no satisfactory advance was being made towards the settlement of the vexed question of war debts and reparations. Of the five countries—Great

WAR DEBTS AND REPARATIONS

War Debts	Total Debt incurred	Total Sum payable in Annuities	Estimated Present Value of Total Annuities at 4½%	Percentage of Cancellation already accepted
	Due to United States (millions of dollars)			
From Great Britain .	4,604	11,106	3,788	17·7
From France . .	4,025	6,848	1,997	50·4
From Italy . .	2,042	2,408	528	74·1
From Belgium . .	418	728	225	46·1
	Due to Great Britain (£ millions)			
From France . .	600	799	256	57·4
From Italy . .	589	277	90	84·9
	Reparations (millions of gold marks)			
From Germany .	136,000*	113,905†	42,183	69·0

* As fixed in 1921. † Under Young Plan.

THE VALUE OF DEBTS IN COMMODITIES

British Wholesale Price Index Numbers (1913=100)		Value of a Debt worth £100 in 1913	British Wholesale Price Index Numbers (1920=100)	Value of a Debt worth £100 in 1920
1920	307	33	100	100
1922	159	63	52	192
1924	166	60	54	185
1926	148	68	48	210
1928	140	71	45	222
1929	137	73	43	232
1930	120	83	39	256
1931	105	95	34	294

Britain, France, Italy, Germany and the United States—chiefly concerned in this problem, one, Germany, was barely averting collapse by the most stringent internal methods of control, and, continually at the mercy of her external creditors, was clearly in no position to make a move. All she could have done would have been simply to repudiate her external debts ; and this would have meant both a world crisis of the most far-reaching kind and the collapse of the German economic system, very probably accompanied by a German revolution. Great Britain, although she had declared herself in favour of cancellation, was unwilling, by offending France, to run the risk of a further financial crisis. France for her part had remained for a long while largely untouched by the effects of the world crisis, which she only began to feel to any serious extent in the early months of 1932. She was still quite indisposed to let the Germans off what she claimed from them, or even to consider a permanent scaling down of reparations unless the Americans were prepared in turn to cancel her debts to them. Finally, in the United States, where depression and financial panic were still spreading fast, there was so large a body of public opinion hostile to any attempt to extend a helping hand to Europe that the Federal Government, though it realised the seriousness of the position, dared not, in view of the impending presidential election, come forward with any constructive proposal.

The Position in 1932. This was the position in the early summer of 1932. There was no hope of Germany being able to resume payment when the Hoover moratorium expired. There was no hope either of immediate agreement by the United States to cancel or scale down European debts ; and there seemed to be little hope that the European countries would agree to cancel reparations in face of the American attitude. The most they seemed likely to agree upon was a further temporary moratorium of some sort ; and even this seemed likely to give rise to considerable dispute.

But it was more than doubtful whether the mere prolongation of the moratorium would avail to save Germany from complete collapse. For, as we have seen, even with reparations in abeyance the Germans were not in a position to meet the remaining demands upon them. The "standstill" agreement of 1931 was indeed renewed on its expiry in January 1932; but the strain on the German economic system continued nevertheless to increase and Hitlerism in Germany to make rapid progress.

Under these conditions, with no settlement of the reparations problem in sight and with existing private credits to Germany constantly threatened with withdrawal, any renewal of confidence was clearly out of the question. Complete chaos in Europe was being barely averted from month to month; and not only in Germany but also in Eastern and Southern Europe fresh dangers of default were arising every day. Meanwhile economic as well as financial conditions continued to go from bad to worse; and the prospects of a successful reconstruction without an intervening disaster grew smaller day by day.

It is true that, when the Lausanne Conference did at last meet in June, the changed attitude of the French seemed to bring some sort of settlement a good deal more within the range of praticality. There was at any rate a general realisation that a failure to deal with the problem would be likely to precipitate a 'Nazi' Revolution in Germany, followed by direct and formal repudiation, not only of Reparations, but probably of other parts of the Versailles Treaty. This helped to bring the French to a more accommodating temper, and to improve the prospects of agreement on paper. But it remained questionable whether a paper agreement would be worth much in practice; and it was clear that even a settlement of the Reparations problem would do little to promote European recovery, without a tackling of the wider economic issues which underlie it. The attempt to tackle these bigger questions was, however, put off to an International Conference to meet later in the year, if possible with American participation.

It is easy enough to see that this state of affairs is merely idiotic, and disastrous from any point of view save that of a believer in world revolution as the one possible way out of the tangle. But idiotic as the situation is, no one country by itself can do much to alter it; and the heart of the problem lies in the inability of the various countries so to reconcile their varying national standpoints as to make common action possible. Indeed, one is tempted, after the experiences of the past few years, to agree with the Communists that there is no practicable solution along constitutional lines—none, that is, which the nations concerned are in the least likely to bring themselves to adopt in time to avert disaster. It is perfectly plain that, settlement or no settlement, Reparations are not going to be paid. That being so, the Allied Powers will presumably also default in respect of their payments to the United States; and in this the Americans, whatever they may say, will also have in fact to acquiesce. In this way, by a general *de facto* repudiation, the situation may be eased for a further period—possibly for long enough to enable the world to learn a little sense and arrive at a better understanding of elementary economic facts. But even this is a startlingly optimistic view of the situation as it exists to-day.

Moreover the success of any such measures is bound to depend on what happens in the near future to world trade, production and finance. If, by some miracle, there were to be a world revival accompanied by a substantial increase in the level of prices, such problems as war debts and reparations would loom much smaller in the world's economy, and be far easier to deal with. The fall in prices and the slump in trade—two aspects of the same thing—have conspired greatly to increase the burden of all debts while diminishing the resources in the hands of the debtors. The fall in prices has, in addition, led in all countries to an insistent demand from manufacturers for protection against foreign dumping; and the erection of higher tariffs and the imposition of more and more restrictions on imports have followed in creditor as well as in debtor countries. If,

however, creditor countries effectively exclude imports from debtor countries, how can debts possibly be paid? It is in the last resort impossible for America to expect at the same time to exclude European goods by means of a high tariff and to be paid what Europe owes her.

A world recovery of prices, by easing the position of industrialists, would greatly reduce the insistence of the demand for protection, and prepare the way for a reduction of tariffs and the removal of obstacles to world trade. But it is highly improbable that any revival in prices will come about automatically as long as trade remains depressed, or that trade will revive as long as tariffs and debts remain at their present height. In fact the entire problem hangs together as one; and the raising of world prices calls just as much for concerted international action as the settlement of the problem of world debts. The world's difficulties will not pass away of themselves. They can only be dealt with by concerted world action; and the question is to decide from what angle they can best be tackled in the first instance. With these various aspects of the problem I shall be dealing in subsequent chapters of this book. But before I come to deal with them I want first to look back at the development of the present world economic system and secondly to attempt a brief survey of the outstanding characteristics of that system as it exists in all the great countries of the world, with the single exception of Russia.

CHAPTER III: TWO CENTURIES OF ECONOMIC GROWTH

1. The Coming of Industrialism
2. Economic Imperialism
3. Great Britain, Germany and the Far East
4. Machines and Men

§ 1. THE COMING OF INDUSTRIALISM

THE GROWTH of civilisation, in its economic aspect, consists essentially in the development of man's command over nature. For many thousands of years, generation after generation of mankind went on living in the possession of vast potential resources of production which they lacked the knowledge to use. There was coal under the earth ; there were rich mineral deposits of many other kinds ; vast latent powers of fertility existed in the soil, and in the unexplored possibilities of breeding and selection of crops and stock ; the powers of steam and electricity were there, unknown and unused. To-day, mankind has knowledge of these things ; and, for good and ill, modern western civilisation is the outcome of this knowledge. But how much remains unknown ; and of what is known how small a proportion of the human race has yet been able to take advantage ! The great majority of the earth's inhabitants are still living in China and India and Africa, under essentially primitive conditions ; and even in the more developed countries far less than full use is being made of the constantly expanding powers of production.

Yet it is in the nature of these powers to expand fast and continuously, as soon as any section of the human race has escaped from the bonds and traditions of a static form of

society. One invention lends to another, in an endless chain of development ; and science, even when it is not aiming deliberately, as in the applied sciences, at economic advancement, is constantly throwing off discoveries which become of the greatest importance in the economic sphere. The outstanding difference between modern western civilisation and every other civilisation that has ever existed is—not indeed that it is dynamic while they were static, for nothing in human affairs is ever really static—but that modern industrialism by its very nature aims not at a static and balanced perfection, but at a constant movement from one victory to another over the forces of nature. It cannot stand still ; but neither can it, even for a moment, wish to stand still. A static condition is fatal to it. because it is always being urged on by its own successive discoveries to production on a larger and larger scale, to an unending expansion of markets as the necessary condition of productive stability, and to changes in the forms of economic organisation corresponding to the development of its productive powers.

So much is, since the days of Marx, common doctrine among all schools of economic historians, though it has not, even now, forced its way into the minds of most of the professional economists, who persist in their attempts to analyse these rapidly changing forces in static and inappropriate terms. For modern economic theory took shape just as western Europe was plainly beginning to pass from the old conditions, in which the preservation of static equilibrium seemed a possible formulation for the life of society into the new industrialism which made any such aim illusory and out of date ; and it failed then to appreciate the real significance of the new forces, or to find new concerpts appropriate for the study of them. That is why orthodox economics has given men so little help in their efforts to master the problems of the modern world. Conservative above all else, whereas the physical sciences are endlessly progressive, it has offered no clue towards the understanding, and therefore no help towards the mastery,

of the new economic forces which men are setting out perforce to control.

The swiftness of the onset of these new forces has to be set clearly against the background of the slow-moving centuries before their coming, if their true nature is to be effectively understood. It is said that the Alexandrians discovered the steam-engine two thousand years ago ; but it remained a toy, and was soon forgotten, without effect upon the world's history. The Roman Empire had a population and an international market, with the Mediterranean as its centre, fully large enough to have provided the basic conditions for a system of mechanical mass-production, as well as of capitalistic exchange. But Roman civilisation, despite its great achievements in irrigation and architecture, and in the organisation of large-scale marketing, never passed beyond the mercantile stage, or dreamed of the potentialities of large-scale industrial production. It is less wonder that the Middle Ages, with its economic system shut up within the confines of walled towns and manorial villages, never departed, in the economic field, from the idea of a static society. For the Middle Ages subordinated science to religion ; and medieval speculation took an essentially non-economic turn. But what was there to stop the Roman Empire from building on the foundations laid by Greek learning an economic power corresponding to the magnitude of its political conquests ? Materially, as far as we can see, nothing ; for most of the explanations that have been offered are exceedingly unconvincing. It simply did not happen : it simply did not begin to happen. But, if once it had begun to happen, no power on earth—not even the invasions of the barbarians—could have stopped it from going on.

But about two centuries ago, above all in England but also to some extent in other parts of Western Europe, this long-delayed epoch of technological discovery did at last begin. Why it began just then is no easier to say than why it did not begin much earlier in the history of mankind. It can indeed be said that, by the seventeenth century,

the old, static, localised economy of the Middle Ages had, in England at any rate, been thoroughly broken down. The artificial barriers in the way of the development of new productive forces had been destroyed. Internal peace had been achieved under the Revolution settlement of 1689 ; and British commerce, especially after the unification of England and Scotland, had become free to develop on national lines. It can be said, in addition, that the discovery of America and the development of sea-borne trade with the Far East had widened immensely the commercial opportunities of Europe, and opened up, for the first time since the fall of the Roman Empire, international markets big enough to make possible the large-scale exchange of complementary products. The foundations of a world-wide economy were being laid ; and there was ample incentive, in the rapidly expanding world market, to seek for means of increasing productive power. It is plausible to represent the great inventions from Kay's flying-shuttle to Watt's steam-engine, and from Bakewell's experiments in stock-breeding to the discovery of chemical fertilizers, to the expanding opportunities open to industrial and agricultural development because of the widening of the world market. But, while these conditions helped very greatly in speeding up the growth of modern industrialism where once it had been given a start, they are totally inadequate to explain why it started at all. There is, in fact, no purely rational explanation which will cover both the failure of the Romans to hit on the methods of large-scale production, and the success of the modern world. It happened so ; and that is almost all we can say.

It is not, however, quite all ; for we can add that, unless the conditions had been favourable for the use and development of the new powers of production, the initial discoveries of the seventeenth and eighteenth centuries might have passed as unregarded as similar discoveries had done long before in Alexandria or in China. The first discoveries were applied to industry because industry, faced with a growing market which it was unable to supply by the old

methods, was eager to make use of them ; and when once their application had begun, the rest followed as a matter of course. One invention led on to another ; and every invention helped to widen the market as well as to increase the available supply of goods.

Moreover, especially in Great Britain and North America, the economic structure of society was favourable to the rapid exploitation of the new productive powers placed at the disposal of men. The collapse of the Gild system in industry and of feudalism on the land, combined with the expansion of the market, had produced a condition favourable to innovation, and created in both industry and agriculture large classes of ambitious small-scale producers eager to get more wealth, and not trammelled by any powerful system of corporate regulation. There were everywhere men ready to experiment, and with just enough capital, or just enough credit to get the capital, to possess themselves of the new machines, which were not at the outset so complicated or expensive as to call for the aggregation of capital into large masses for their use. The new spinning machines, and later power-looms and even steam-engines could be bought or rented by men who had no more capital than it was possible to accumulate by means of small-scale production, or to borrow from merchants who had made it in the old way of trade. Countless small masters experimented with the new machines ; and, though many failed, many succeeded and grew rich enough continually to expand their scale of production, and to buy the newer and more expensive machines which successive inventions brought into the field. In these circumstances, the idea of industrial progress came to be inseparably associated in men's minds with the ideas of individual initiative and private competitive enterprise—and this association has remained firmly fixed in the minds of successive generations, even in face of the growth of huge joint stock companies and trusts, and of an evolution of productive technique which has put the command of the necessary resources for efficient production at any rate in

the basic industries far beyond the power of any single individual.

It is out of the question, in a single brief chapter—and I have space for no more in this book—to describe the successive stages by which modern industrialism has grown up from its initial emergence out of the commercial Capitalism of the seventeenth and eighteenth centuries. It must suffice here to indicate very briefly those features of its development which are of the greatest importance for the understanding of its present difficulties. For I am not writing Economic History, but only calling upon it for such light as it can throw upon the faulty working of the economic system of to-day.

Broadly speaking, the great change which is commonly called the "Industrial Revolution" extends from the middle of the eighteenth century to the present time. We are still in the midst of it; and a large part of the world is only now passing through its earlier stages. Even the most advanced countries have still by no means mastered its lessons, or adapted their organisation and ways of living to the opportunities which it affords; and hardly the first step has been taken towards that creation of a closely knit world economic system without which it is impossible for nations equipped with the modern instruments of production to live in health and security. So far, mechanical forces have been allowed to make a disorderly conquest of country after country with little or no attempt at collective guidance or control. And accordingly these unregulated and un-understood forces have come near to tearing the world in pieces, and bringing civilisation to disaster instead of helping it to create a fuller and happier way of living for all mankind.

The "Industrial Revolution" began at a time when commercial expansion was already doing much to increase the world's wealth by acting as a stimulus to higher production. Widening markets and growing towns created a demand for an increased output of both industrial and agricultural goods. Accordingly, as fast as men found out now to apply improved machinery to industry, to develop

the use first of water-power and then of steam, to increase the yield of arable cultivation and to breed better animals for the provision of meat, wool, hides, and dairy produce, the new discoveries were eagerly taken up, wherever there was a sufficient assurance of peace and internal order to make economic development possible. In Europe, these necessary conditions existed above all in Great Britain ; and, as soon as the War of Independence was over, they existed to an even greater extent in the United States. In Europe, the Napoleonic Wars did much to hold back the exploitation of the new productive powers. This applied in some degree even to Great Britain, owing to the financial strain caused by the war and the long dislocation of the European markets. But it applied much less to Great Britain than to any other European country ; and the immunity of British soil from invasion and the bottling up of the Continent by blockade were among the principal reasons why Great Britain in the early decades of the nineteenth century established her long lead over all other countries in the development of the new productive powers. The United States kept well abreast of her in agriculture, and for a time in shipbuilding. But the chief attention of the Americans, with their small population, was concentrated for the time on agriculture rather than on industry ; and Great Britain was left almost without rivals in building up a world trade in machine-made industrial goods.

The "Industrial Revolution" began as a two-fold movement—in productive industry and in agriculture. During the later decades of the eighteenth century and the first quarter of the nineteenth it revolutionised in Great Britain not only the greater textile industries of cotton and wool, but also the mining of coal and the production of iron. At the same time agriculture passed through changes no less far-reaching in their effect. The enclosure of the open fields and the commons, carried through with a ruthless disregard for its consequences to the rural population, was a response to the greatly expanded opportunities

for the profitable exploitation of the land. High war-time prices, based on the expansion of war-demand and the scarcity created by devastation in Europe, greatly stimulated this movement ; but it was fundamentally due to the advance in agricultural knowledge, which made men impatient of the traditional methods of cultivation and stock-raising, and determined to create conditions of land-tenure that would make possible a more productive use of land. The improvement of agricultural methods which accompanied the enclosure movement and the rapid mechanisation of the textile, mining and metal industries under the stimulus of steam-power together constitute the first phase of the " Industrial Revolution."

Even in Great Britain these changes had been by no means completely carried out, and in the rest of Europe they were only beginning, when the " Revolution " entered on a second phase. This consisted essentially in the extension of the new forces from production to transport. As the output of both industrial and agricultural goods increased, the inadequacy of the existing means of transport became more and more obviously a serious obstacle to economic growth. The answer was found, in the second quarter of the nineteenth century, in the application of steam-power and of the productive resources of the metal industries to the creation of improved means of transport by both land and sea. The railroad and the steamship, the locomotive and the ironclad, equipped the world with the means of carrying far more goods far more swiftly over a far larger part of the earth's surface. Carriage of goods by sea became easier, quicker and more certain, as well as cheaper ; and carriage by land was revolutionised to an even greater extent. Above all, the emergence of the new forms of transport opened up the interior of vast continents to external trade, and created conditions which bound the whole world together into a single economic unit within which national prosperity became more and more dependent on international happenings, and every economic problem came to be a world-problem, calling for concerted

action on an international scale, or creating world-wide confusion if the nations refused to act in harmony for its solution.

§ 2. ECONOMIC IMPERIALISM

THIS second phase of the "Industrial Revolution" is connected inseparably with the growth of transport, and of the metal trades which provided the means of transport. In the second quarter of the nineteenth century coal, iron and engineering laid the foundations of the new system of transport. Great Britain had built her main-line railways mainly between 1826 and the early 'forties; and thereafter she set out to use her acquired skill and experience in the profitable task of railway-building for the rest of the world. Great railway contractors such as Brassey, finding orders no longer plentiful at home, began to look further afield; but undeveloped countries could not afford to pay "on the nail" for expensive railways, however great the prospects of economic expansion by their means might be. Very well, British people, enriched by the profits of earlier ventures, could afford to lend the money as well as supply the skill. British capital, British technicians, and British skilled labour undertook the task of equipping a large part of Western Europe, and later India and the Argentine, China and Africa, and many other parts of the world, with the new means of transport.

Railways and Capitalism. Railway construction occupies indeed a position of extraordinary significance in the evolution of modern Capitalism. On the one hand it has been the means by which the hinterland of vast continents has been opened up to trade, and jointly with the steamship the instrument whereby the raw materials and the producing capacity of the New World, of Africa, and of the East have been made available for European use; and on the other hand it has largely influenced and determined both

the structure of capitalist business and the growth of overseas investment as a means of hastening the spread of power production over the world as a whole.

The railway played a far more important part than the steamship in the promotion of international trade. For the steamship for the most part only enabled goods to be carried faster and in greater quantities along the familiar routes of commerce, whereas the railway multiplied many times over the area of the world open to commercial exploitation. Industrialism, before the coming of the railroads, could be hardly more than a fringe of smoke round the seaboards of even the most advanced countries. The railways industrialised, or at any rate commercialised, the interior as well. Above all else, they were the making of the United States as an advanced industrial nation.

But railway development was also of very great importance in its effects on the structure of the business system. The railway company, as it grew up in Great Britain in the second quarter of the nineteenth century, was indeed modelled in its business structure on the earlier turnpike trusts and canal companies, which, like it, had needed to get special powers by private Acts of Parliament, because they needed the authority to invade private rights in order to construct their plants. But the railway company in fact developed on quite new and different lines ; for so large a mass of capital was needed to finance the host of projects for new railway construction that the money could be got only by making mass appeals and drawing in large sections of the public who had been previously quite unused to industrial investment of any kind. The railway promoters, appealing for capital to the rising middle class of Great Britain, created the typical modern joint-stock concern, with its widely diffused body of shareholders and stockholders, too numerous and too scattered to exercise any effective control over its conduct and interested in it solely from the financial point of view. The experience of railway flotations and railway stockholding prepared the way for a general acceptance of the

joint-stock system, and for the final concession of limited liability in all industries under the British Companies Act of 1855. There were of course other pioneers of joint-stock besides the railways—gas and water companies, for example—but in the evolution of the joint-stock system and in the widening of the investing public the railway played throughout the dominant part.

No less significant has been the rôle of the railways in the internationalisation of the supply of capital. British overseas investment had indeed begun before the coming of the railways ; and there had been large private investments in the West Indies and in North America during the eighteenth century. Moreover, after the Napoleonic Wars there had been a boom in overseas issues, especially to the South American States which had just thrown off the Spanish dominion and were looked to as hopeful and expanding markets for British goods. But before the epoch of overseas railway construction there was little investment of capital abroad except in government loans or in purely private ventures such as the plantations of the West Indies. It was mainly through the building of railways overseas that British investors first learned to trust their money in foreign industrial ventures ; and here, too, what began with railways soon spread to other industries as well. The export of capital has taken a great and increasing place in the economic development of the modern world, and in this sphere, as in home investment, railway enterprise has been the pioneer.

The Migration of Capital. In this great movement of overseas investment Great Britain, the only country with any large mass of surplus capital to invest, led the way. The rapid growth of her capacity to export goods gave her the necessary resources ; but her exports could not develop to the full in a world much poorer than she was unless she was prepared to lend to other countries the means of buying what she had to sell, and content to receive a deferred return as interest on her lendings. As we have seen, this

overseas lending was in its early stages mainly confined to public loans, but after the coming of the railways it expanded into industry on a steadily increasing scale. In 1850 British capitalists had already perhaps £230,000,000 invested abroad, mainly in government stocks, with a sprinkling of commerical and mining investments. By 1876, according to the most reliable estimates, the total had increased to about £1,200,000,000. Between 1860 and 1876 nearly £950,000,000 of new capital issues for overseas use can be traced in the London market. Rather more than half this total consisted of government loans, including railway guarantees, and rather less than half of all other investments put together. The railways in the United States alone absorbed over £70,000,000, and railway securities easily occupied the next place after public loans. It has been estimated that in 1914 British investors had at least £4,000,000,000 invested abroad, and of this sum more than £1,500,000,000 was in railway securities and £1,000,000,000 in government loans.

No other country had in 1914 even half so large a total overseas investment as Great Britain. France is estimated to have had about £1,800,000,000; Germany, about £1,200,000,000; and the United States about £540,000,000. The foreign investments of the United States were mainly in South and Central America; while the French and Germans invested mainly in Europe and in their own colonies. But in all cases the total included a large mass of investments in railway securities, besides the proceeds of government loans which had been devoted to the building of State-owned railway systems. France, outside her own colonies, had specialised chiefly in public loans and in the financing of the economic development of Russia; while Germany had distributed her investments about equally between Europe and the rest of the world, with a preponderance of fixed-interest-bearing securities. Only British investment was very widely spread over all countries and every type of bond and share, both public and private.

Undoubtedly this heavy investment of capital overseas

greatly speeded up the economic growth of the more backward coun..ies, and stimulated in the more developed areas the expansion of the industries producing capital goods. It was indeed largely a result of the concentration of income in the hands of the richer sections of the community, for this both increased saving and limited the home market for consumers' goods, and thus provided an incentive to the economic system to be always on the look-out for fresh markets abroad in order to absorb the growing productivity of the mechanised trades. If wages had risen faster in the older countries, the aggregate increase of wealth in the world as a whole might have been slower, and the industrialisation of the less advanced areas would probably have been delayed. But there would have been in the developed countries a better diffusion of wealth, and there would also have been less international rivalry, less imperialism and subjection of the weaker peoples, and less sowing of the seeds of war.

Is Foreign Investment a Good? Yet, obviously, it is a good thing for the richer and better-equipped countries to help on the development of the less advanced. And obviously they ought to be able to do this without either subjecting the borrowers to their political control or quarrelling with one another for the right to help in their expansion. But, as the world is, the less advanced countries do not so much borrow money from the more advanced as have loans thrust upon them even against their will. And the more advanced countries are constantly squabbling for the right of their nationals to make these loans. The enterprises started in the less developed countries are often not only financed by alien capital, but also conducted under alien control by companies registered and administered in the lending country. The profits of the enterprise are remitted home to the alien owners; and the country in which the enterprise is carried on, unless it is recognised as a fully civilised nation, has to submit to alien policing and often even to virtual annexation, either open or disguised under

the form of a protectorate. Its citizens are in effect forced to labour for the alien capitalists whether they will or no ; and sometimes a large part of its tax revenue is earmarked as security for the payment of interest on the alien capital. The world, in the latter part of the nineteenth century, became far less tolerant of uncivilised peoples, or even of peoples backward in relation to Western standards of economic progress. While Europe was asserting within its own borders the rights of nationality and self-determination, it was also denying the right of non-European peoples to abstain from using to the full the potential wealth of their lands and their labour, and was claiming the right to enforce the development of any territory occupied by uncivilised peoples, even against the will of its inhabitants, as part of the civilising mission of the white races.

Of course from the standpoint of the European, with his faith in the virtues of large-scale production, there is a case in support of this attitude. Modern industrialism can develop only if it can find both expanding markets for its products and growing supplies of foodstuffs and raw materials which it can receive in exchange for them. It needs not only the produce of the prairie lands of America and the ranches of Australia, where there are relatively few natives to be dispossessed, but also that of tropical Africa, rubber from Malaya and the Dutch East Indies, and a host of other commodities from countries already thickly populated by native inhabitants who would not produce enough for the market except under the stimulus of white intervention. Why, asks the European, should these native populations be allowed to ignore the vast economic opportunities of the regions in which they dwell ? Their own standards of wealth and civilisation can rise only if they are taught how to use the resources lying ready to their hands. And only the white man can teach them. That is his mission—a mission of civilisation for the world as well as of enrichment for himself, a mission made necessary in the interests of the progress of industrialism. National self-determination, according to this view, holds good only for peoples who have

their eyes sufficiently open to the economic main chance. A sentimental regard for nationalism must not be allowed to stay the civilising march of the industrial system.

Imperialist Rivalries. But, unhappily, the white men do not march on their civilising mission as a united army. They dispute and even fight one with another for the right to exploit the less developed regions of the earth. The partition of Africa was accomplished without actual war between the great Powers which have divided up practically the whole continent, but not without recurrent threats of war. In 1918 the colonial empire of Germany was parcelled out among the victors ; and, though the form of annexation was hidden under the cloak of the mandatory system, and each annexing Power pledged itself to administer its mandated territories in the interests of their inhabitants, in effect most of the mandated areas were virtually added to the empires of the victorious Allies. One thing, indeed, was secured—the " Open Door " in these areas for the commerce of all nations—but with that exception the mandatory system differed little from positive annexation.

The root of the trouble lies largely in the need of the developed countries for ever-expanding markets and sources of supply to keep their industries at work. For it is not in the nature of modern industrialism to stand still. It must either grow or decay ; and if it is to grow it must find a market for its products largely outside its own borders. For, especially in Great Britain and Germany, industrialism has grown up, not as a balanced scheme of production and consumption, but as a system of narrowly specialised production of certain classes of machine-made goods based largely on imported raw materials, and demanding the import of large quantities of foodstuffs as well. Any system of this sort must sell in order to buy, and it can raise the standard of living at home only by selling more and more of its products abroad. It must, moreover, if it is to have more to sell, assure itself of a constantly growing supply of necessary raw materials. This has been much less true of

France than of either Great Britain or Germany, and less true still of the United States, with its vaster territory and its more balanced economic resources. But it has been increasingly true of every industrialised country in modern times. The inevitable result of this situation is seen in the growth of Economic Imperialism and in the rivalry of the great Powers for the effective possession of sources of supply as well as of expanding markets for their products. The struggle for oil furnishes an outstanding example.

There have been, indeed, here and there attempts to transcend these rivalries and to join forces in a concerted attempt at the exploitation of the less developed areas. The China Consortium is the outstanding example of this policy. China is far too vast and too densely populated for annexation of the main part of her territory to be possible, though outlying areas, such as Manchuria, can be successfully annexed, at least for a time, as Japan has recently demonstrated to the world. Nor can China proper be divided up, as Africa has been, into separate spheres of influence ; for all the Powers want to make use of the old-established centres of Chinese trade and of the great ports and rivers. No one Power would let any other have a monopoly of Shanghai and the trade of the Yangtse ; so an uneasy partnership of the Powers has existed for the exploitation in common of the economic possibilities of China as a market and as a sphere for concessions and for the investment of capital. A number of national groups have participated in the building of the Chinese railways, and common rules have been laid down to guide the conduct of governments and syndicates of investors in their dealings with the Chinese. But this system has not destroyed national jealousies or rivalries or protected China from foreign intervention, nor has it even sufficed to prevent Japan from occupying Manchuria, despite the objections of the other Powers. For the great Powers are too jealous one of another to act effectively in concert.

The Growth of Empires. In sum, the latter half of the nineteenth century was marked by the development of a new kind of economic Imperialism. Between 1884 and 1900 the territory of the British Empire was increased by more than 3,700,000 square miles, containing over 57,000,000 inhabitants. France annexed three and a half million square miles, with over 36,000,000 inhabitants, and Germany, far less favourably placed, built up, chiefly in Africa, a colonial empire of over one million square miles, with nearly 17,000,000 inhabitants. The United States took over Cuba, the Philippines, Hawaii, Alaska. Italy followed France and Great Britain into Northern Africa. Russia and Great Britain squabbled over Persia, and intrigued in Afghanistan and the States of Central Asia. France, Spain and Germany fell out in Morocco. Belgium, under Leopold, attempted to develop the Congo on lines which shamed the conscience even of an Imperialist world. In 1914 it was almost true that there was no territory left on the face of the earth which had not been appropriated by one or another of the "civilised Powers." The great exception was China, too tough a nut for even modern civilisation to crack : and China, because she could not be partitioned, found herself at the mercy of the intrigues and rivalries of the great Powers. All the world over, Economic Imperialism had become the dominant force in world politics, and behind Imperialism loomed the ever-growing threat of war.

§ 3. GREAT BRITAIN, GERMANY AND THE FAR EAST

THIS study of the influence of the new methods of transport in the course of economic development has led us right on from the rise of the railroad and the steamship to the world of to-day. But it is a characteristic of the "Industrial Revolution" that each successive phase of its growth does not supersede the forces which were previously in

action, but stands for the superaddition of new forces which stimulate the continued influence of those already in being. The development of transport did not replace the mechanisation of the productive system or the improvement of agricultural methods as the instrument of material progress. It enabled these to advance faster than ever, and over an ever-widening field. For by widening markets and enabling goods to be carried faster, further and more cheaply by both land and sea, the improvements in transport made possible a far greater production of goods, and also a much larger measure of national as well as local division of labour based on the international interchange of goods. Indeed, it can be said with truth that in the latter part of the nineteenth century the "Industrial Revolution" entered upon a third phase, in which neither production nor transport in itself played the dominant part, but both acted together to spread industrialism at an ever-increasing pace over a larger and larger area. The industrialisation of Germany in the latter part of the nineteenth century was based essentially on the metal industries and on the railways, which did fully as much as the *Zollverein* for the unification of the German economic system. Equipped with railroads which opened up her vast interior as fast as she was able to people it, the United States was able to embark on large-scale industrial production for her rapidly growing home market as well as to expand her output of foodstuffs and raw materials destined for the world market; and thereafter, as her population and her industries grew, she tended to become more self-sufficient, and to base her economic system more on the internal exchange of industrial for agricultural goods. Hence the rise of American protection, and her ability, almost up to the present time, to hold herself largely aloof from European economic complications and to refrain from large adventures in the building up of a huge colonial Empire. For the United States had, until very recently, enough openings at home to absorb nearly all her energies. The world market and world economic conditions were of no such overmastering

importance to her as to Great Britain or Germany. France too, with her strongly entrenched peasant agriculture and her continued devotion to small-scale industry, was still relatively little dependent on the world market ; for it was not until after the annexation of Alsace-Lorraine in 1918 that the heavy industries grew strong enough to have an influential voice in the framing of French policy. France, however, was, as we have seen, an exporter of capital, and the possessor of a large and growing colonial Empire ; and these conditions gave her a very definite interest in the world economic problems from which the United States was still able largely to stand aloof.

In the eighteenth century, France and Great Britain had been the great commercial rivals. But the immediate issue between them was settled by the Napoleonic Wars ; and in the nineteenth century the different development of their economic systems tended to remove the causes of rivalry. The new industrialism made Germany and Great Britain the protagonists of the struggle for economic power. For German industrialism, beginning much later than British, developed along lines which led directly and inevitably to the keenest economic rivalry. Germany did not, indeed, seriously challenge British supremacy in the textile trades ; but she set out with concentrated energy to develop just these industries which were ousting textiles from their old predominance in international trade. The great new discoveries in the technique of steel-production, from the Bessemer and Siemens processes in the 'fifties and 'sixties to the inventions of Gilchrist and Thomas in the 'seventies, came just in time to provide the basis of the new German industrialism. Great Britain had to scrap and re-equip her great iron industry in order to adapt it to the new opportunities for the mass-production of steel. In the new age of steel Great Britain and Germany then started level as rivals for the command of the rapidly expanding world-market ; and the possession of Alsace-Lorraine and the Ruhr enabled Germany to forge rapidly ahead. In the middle 'eighties British steel production was still more than

twice that of Germany, and still ahead of that of the United States, which was practically all absorbed in the home market. But in the 'nineties the American production easily out-distanced the British ; and early in the twentieth century Germany also went ahead of Great Britain in the production of steel. At the same time, there was a great development in the metal-using industries ; and the German producers became the most important rivals of the British in the world market for a wide range of engineering products.

Anglo-German rivalry thus came to be the dominant factor in the political relationships of the new era of Economic Imperalism. But internally the economic systems of these two rivals for the world market for manufactures were radically unlike. Germany had a protected home market, whereas Great Britain admitted imports freely from all other countries. Great Britain had large capital investments abroad, on which she received interest chiefly in the form of goods ; whereas Germany was still a debtor country, borrowing capital from abroad. The Germans were, indeed, also beginning to invest abroad on a considerable scale ; but they still borrowed on balance more than they invested. A further significant contrast between the two countries was that in Great Britain, in accordance with *laissez faire* ideas, the State interfered as little as possible with industry and commerce, whereas in Germany these had grown up with direct encouragement from the State and largely under State tutelage. The British railways were private and competitive, whereas the German railways were State-owned and State-administered. British banking and finance were largely internationalised in outlook and as ready to provide money for financing transactions between foreigners as for British industry and trade, whereas German banking regarded itself definitely as the auxiliary to German productive and commerical development. Trusts and combines, though they existed in large numbers in Great Britain, were still frowned on by public opinion and secured no recognition from the law ; but in Germany the

organisation of industry in cartels and similar bodies was actively encouraged by the State, which actually participated in the famous Rhenish-Westphalian Coal Cartel. Germany had a large peasant population and protected her agriculture as well as her industries, whereas in Great Britain the peasantry had long disappeared and farming in all its forms was exposed to the full rigours of world competition. Above all, the temper of British business men, formed in the early part of the nineteenth century, was strongly individualistic and internationalist in the sense that the British producer thought of himself as concerned with the world market and took little account of political boundaries. The temper of the German business man, on the other hand, was far more nationalist; and he was disposed to seek the realisation of his aims through collective action under the encouragement and protection of the national State.

This disposition to act collectively ministered to German success in the rapidly growing heavy industries, which responded far more readily than the textile trades to methods of large-scale organisation. There was little advantage in making cotton-mills or woollen-mills very big; whereas technical changes in the metal trades were making larger and larger units of production indispensable to cheapness, and were also creating the need for a growing specialisation in the product of each particular factory. This involved not only the accumulation of capital in large masses—for which Great Britain was better equipped than Germany—but also a spirit of co-operation among the different firms in the same trade—and for this Great Britain was by no means so well equipped. It is true that right up to 1914 the British metal and engineering trades continued to make very rapid progress, but in Germany these trades went ahead faster still and commanded with every year a greater share in the total world market.

Up to the middle of the nineteenth century the new industrialism had taken root only in Western Europe and to a less extent in the United States. The Far East had been

for centuries of vital importance to Europe as a source of supply for fine textile fabrics, luxury foodstuffs, and a few easily transportable materials; and with the rise of the cotton industry towards the end of the eighteenth century it had become important as a market also. Africa had been of account in the eighteenth century chiefly as a hunting ground for slaves who could be caught or bought for sale in the American plantations; and its commercial importance dwindled after the suppression of the slave trade early in the nineteenth century. Canada was a sparsely populated agricultural country, supplying furs and timber, and becoming after 1840 of some account as a producer of grain for export. The only important Canadian industry was shipbuilding, and that died out after the introduction of steam-ships made of metal. Australia and New Zealand had between them a population of less than 200,000, and were of little economic account, though the production of fine wool had begun, until after the gold discoveries of 1851. In South America, Brazil had been from early in the century an important market, and there was a growing trade with the Argentine, Chile and Peru; but these countries were, until the latter end of the nineteenth century, still at a rudimentary stage of economic growth.

The half-century before 1914 witnessed, besides the vast growth of the United States and the rapid industrial development of Great Britain and Germany, a swift extension of modern commercial and industrial methods to new countries. Japan, long almost isolated from world trade, not only opened her ports to foreign commerce but proceeded with extraordinary thoroughness and speed to equip herself with the productive technique of the Western world. British capital covered India with a network of railways, and developed her productive resources for the supply of Western needs. The European occupation of Africa, previously confined to a few areas within easy reach of the coast, broadened out until practically the whole continent had been annexed by one or other of the European powers. Russia, the granary of Europe, borrowed

capital extensively from richer countries to build railways to link up her vast territories in Europe and Asia, and attempted behind a very high tariff to create modern industries of her own. New commodities, such as rubber and oil, immensely increased the economic importance of Malaya, the Dutch East Indies, Mexico, Persia and Burma. Commerce ceased to be confined to the old trade routes, and ocean-going ships carried everywhere the mingled blessings and curses of modern civilisation. A fever of railway-building seized on the world and provided vast openings for the investment of capital in the less-developed countries. Trade, which in the earlier part of the nineteenth century had been mainly the exchange of goods for goods, came to depend to a growing extent on the investment of capital abroad by citizens of the older countries ; and with this investment of capital came a startling revival of Imperialism and a renewed tendency to political interference by the more advanced nations in the affairs of the less developed. For, when you sell a man a shirt, that is an end of the transaction. But when you sell him a railway, for which he can hope to pay only by instalments spread over a long period, you continue to take a lively interest in what he does with it. The investing countries came to have a stake in the debtor countries, and to regard the existence of orderly and debt-honouring Governments in these countries as one of the rights of property. Moreover, the advanced countries set to work to extend their colonial empires in search both of markets for their products and of closed sources for the supply of foodstuffs and raw materials for their use—or even merely for the sake of preventing their rivals from occupying territories which they might want at some future date.✓

Why Economic Imperialism Arose. The recrudescence of Imperialism in the latter part of the nineteenth century was in fact no mere causeless change of political attitude. It was based on a profound alteration in the economic relationships between the countries of the world. Cobden

and Bright and most of their contemporaries in Great Britain had believed that it was only a matter of time for the white colonies to proclaim their independence and become sovereign States, as the United States had done in the eighteenth century. Not that they objected to this; for they had been convinced that trade would develop all the faster if no attempt was made to influence it by political pressure. In the native areas included within the British Empire, with the exception of India, the early Victorians took little interest; and in India their chief concern was for the expansion of the market for Lancashire cotton goods. They looked at the world with the eyes of traders in finished consumable commodities, and their creed of *laissez faire* followed logically from their economic ambitions.

But other countries, as they adopted the new industrialism, found themselves less fortunately placed than Great Britain. Their captains of industry found it hard to compete with the British in the open markets of the world, and they had no comparable colonial empires of their own. Just as they protected their own industries against British imports, so they set out to make such colonies as they had as far as possible closed markets for their own goods—and to get more colonies, in order to secure more protected markets and preferential fields for capital investment. Great Britain, confident in her industrial superiority and in her ability to lend capital more readily and on a larger scale than her rivals, felt no need to close her colonial markets to foreign produce, even where she was in a position to impose her own terms; but the newer colonial empires of France and Germany grew up to a far greater extent as closed markets for the goods and capital of these countries.

This does not mean that Great Britain was uninfluenced by the growth of Imperialism. On the contrary, she also set out to annex fresh territory and to build in every part of the Empire railways and other public undertakings which supplied profitable outlets both for British capital and for the products of the British industries making

capital goods. Nor did her activity stop short at the boundaries of the Empire. The Argentine was opened up mainly with British capital and British machinery ; and there was active British investment in China as well as in India and even in colonies belonging to other Powers, such as the Dutch East Indies.

Apart from the rise of the United States, as a largely self-centred economic unit behind a high tariff wall—" the largest Free Trade area in the world "—and the rise of industrialism and economic Imperialism in Europe, to the accompaniment of growing Anglo-German rivalry, the outstanding economic occurrence of the decades before the war was the beginning of industrialisation in the Far East. The conquests of the eighteenth century had left Great Britain with almost a monopoly of the Far Eastern markets, which were above all important to the highly mechanised cotton industry of Lancashire. Great Britain was, moreover, the chief importer for Far Eastern produce for re-export to the markets of Europe and America ; and India and later China were vitally important spheres for the current investment of British capital. Hong Kong, annexed in 1842, became the great depot for British trade with Southern China, and the Chinese were compelled to open Shanghai and certain other ports to British commerce. Then, in 1853, the Americans took the lead in forcing open the closed market of Japan ; and there followed, after the Japanese Revolution of 1867, the speedy transformation of that country into an advanced economic and military Power. With extraordinary thoroughness and initiative competence, the Japanese set to work to master the technique of machine-production and to apply the methods of Western commerce and finance. Japan set herself to develop the production of steel, ships and engineering goods as well as textiles, and to build up an export market in the Far East, with the aid of the ample resources of cheap labour at her command. Her victory over Russia consolidated her position as an imperialist Power ; and the Anglo-Japanese alliance of 1902 was a recognition of her

new importance in world affairs. Then, gradually, industrialism began to spread in India and China, until finally the interruption of European supplies during the world war gave an immense stimulus to industrial production in the Far East, and cut away from under the feet of the Lancashire manufacturers a large section of their most important market. Great Britain, threatened in the metal and engineering trades by the growth of European and American competition, had now to face in addition the threat to her textile industry of Asiatic production based on very low wages and very long hours of labour.

But while industrialism has made a beginning in India and China as well as in Japan, it has so far advanced in both these countries only a very little way. The overwhelming majority of the people in India and China are still employed on or about the land, and even manufacturing production still largely takes the form of handicraft. In China, for example, the quantity of cotton goods produced in the factories, though it has been rising very fast, is still quite tiny in relation to the amount produced on hand-looms. In India, too, even apart from the effects of Mr. Gandhi's propaganda, the hand-loom still supplies the needs of a very large part of the population. It is in spinning rather than in weaving that the greatest advances in factory production have been made.

Far Eastern Competition. This continued activity of hand-loom production does not, however, prevent the competition of Indian and Chinese as well as Japanese factories from being a very serious matter for the exporters of the Western countries, and, above all, of Great Britain. For, though the factories of India and China are a good deal behind those of Japan in efficiency, and of course still further behind those of Europe and America, their excessively low labour costs enable them to sell at low prices, especially in the case of the coarser products, where skill is of less importance in the manufacture. A large part of Lancashire's pre-war market in the Far East for the cheaper

types of goods has certainly been lost for ever to the cotton mills of Japan, China and India. It is certain, moreover, that this Far Eastern competition will continue to increase, and that in time the more expensive as well as the cheaper goods will be successfully produced in the Far Eastern factories. Indeed, on a superficial view, the surprising thing is not that industrialism has advanced in the Far East but that it is not advancing faster. For undoubtedly recent changes in industrial technique are reducing the comparative advantages of the more advanced countries. The new automatic machinery diminishes the need for skilled labour and makes it easier for the less strenuous and less skilled labour of the Eastern peoples to be used at a profit. The real reason why the factory system in the Far East advances so slowly is that the Far Eastern countries cannot find the capital for more rapid development ; for a large proportion of such native accumulation as does exist is absorbed in meeting interest charges on past loans from the Western Powers. The gap is to some extent filled by fresh investments of foreign capital in the Far Eastern countries ; but in both India and China this has been discouraged of late years by the uncertainty of the political situation, while in Japan, where industrialism has grown much more rapidly, there are political as well as economic difficulties in finding markets for the rapidly growing product of the factory system. The Chinese boycott of Japanese goods is China's one effective weapon in reply to the annexationist moves of Japanese Imperialism.

Clearly, the growth of industry based on modern power production in the less developed parts of the world is still only in its very early stages and is destined to exert on the world economic situation a steadily increasing influence. There is no inherent reason why in the long run both China and India should not do what Russia is doing to-day under her Five Year Plan, that is, carry through a thorough-going reconstruction of their entire economic systems, including agriculture as well as industry, on lines of huge-scale collective organisation based on the use of

mechanical power in its most developed forms. There are, indeed, for the present, serious obstacles in the way of this. It is hard enough for Soviet Russia to abstract, at the expense of the low standard of life of the great mass of her people, enough capital to finance her ambitious schemes of industrial reorganisation. But, Russia as a country is thinly populated in relation to the countries of the Far East; and in their case the density of population, the very small size of their crowded peasant holdings, and their extreme poverty, put even greater difficulties in the way of any comprehensive plan of economic development. It would take an immense political upheaval in India or China to create conditions which would make possible either thorough-going Communism on the Russian model or even any very great speeding-up of the rate of capitalist development. But, at the least, the growth of industrialism is likely to be rapid enough in the near future to revolutionise the age-long commercial relations between East and West, and to raise the Far Eastern countries to an altogether new status in the world economic system. And, despite the immense obstacles in the way, who shall say that India and China will not in the near future accomplish political revolutions of their own which will leave them ready to face the arduous tasks and sacrifices involved in economic planning of the Russian kind? In no part of the world is the influence of Soviet ideas so powerful as in the Far East; and although these ideas are bound to need adaptation before they can be applied to the different economic circumstances of India and China, there is no reason to doubt the existence in those countries of forces and personalities strong enough in the long run to bring this adaptation to pass.

§ 4. MACHINES AND MEN

AWAY IN the Urals, where Europe and Asia meet, there is a place called Magnitogorsk—a town planned for a quarter of a million people. Where it stands to-day there

was, only a few years ago, no town at all, but an empty country-side with a great unused store of mineral wealth beneath its surface. But now there have arisen, as by a miracle, great mine workings and factories equipped with the latest machinery from America and Western Europe ; and in and around these new plants a great host of men and women is labouring hard and fast to create in the wilderness a vast new centre of mechanical power. All over Russia there are scenes of that kind, marking a swift transition from primitive conditions which have endured for many centuries almost without change to a new civilisation based on giant power ; and those who control this new development are straining every nerve to apply the most recent technical methods to the mass production of machine-made goods.

In present-day Russia the onset of this new civilisation is swift and sudden beyond all precedent. For Russia is trying hard to leap straight from the most primitive methods of production to the most advanced, skipping all the intermediate stages through which America and Western Europe have passed by degrees. Indeed, she is endeavouring at one leap to advance much further than the United States or Great Britain or Germany has advanced even now, after nearly two centuries of continuous development based on machine production. For she is seeking to mobilise for the new industrialism the entire resources of a vast country and to develop all her rising industries as parts of a single comprehensive plan and under a completely unified control—whereas in other industrial countries industry is still mainly a matter of private enterprise carried on by many independent concerns, and the place of unified planning is supplied by a belief—grown fainter of late years—that somehow, if each business man is left free to pursue his private interests, order and progress will be created by some pre-ordained economic harmony out of a host of chaotic and often conflicting efforts.

Russia has made up her mind to leap straight from a primitive peasant civilisation into the age of electricity and

giant power. She has set out, under her Communist rulers, to accomplish in a few years all or more than all that Great Britain has done in two centuries of gradual development. For even two hundred years ago, Great Britain was, on the whole, mechanically far more advanced than the Russia of 1917.

It is possible to undertake such a task because it is the characteristic of modern mechanical development to proceed at an ever-increasing pace. When power-driven machinery was first introduced its advance was, by any modern standard, extraordinarily slow and hesitant. Watt's steam engine, on which the material progress of the nineteenth century was largely based, achieved no speedy triumph. Even in Great Britain its use spread but slowly for a long time ; and fifty years after its introduction there were still plenty of industries and processes which it had invaded hardly at all. In other countries its progress was slower still. It did not conquer the greater part of the textile industry of either France or Germany until well after the middle of the nineteenth century ; and in every industry and country it made its way piecemeal and by painful stages in face of the strong resistance of employers as well as workers to the abandonment of traditional crafts and methods of production.

Nevertheless, as the nineteenth century advanced, the pace of mechanical change grew much more rapid. For, when the transition to a productive system based on mechanical power had once been made, the improvement of machines and the devising of new methods of production were bound to proceed at an increasing rate. One invention led to another ; and manufacturers, eager to reduce their costs of production, had to be constantly on the look out for new devices. Moreover, as the workers become organised and able to insist on higher wages and better conditions of employment, employers were driven to seek new ways of getting good value for their money by making the dearer labour more productive, or reducing the quantity of it which they used by finding machines to do work previously

done by men's hands or physical strength. Competition between employers and between countries to cut down costs and the desire to reduce prices in order to sell more goods led to a growingly rapid advance in mechanisation; for it is soon discovered that for many kinds of goods huge economies can be achieved by producing on a larger scale as well as by combining to buy materials in greater quantities and to organise sales over the widest possible market. The scale of production grows larger, and the scale of business enterprise larger still. Capital is aggregated into greater masses; and the new means which are devised in order to promote the aggregation of capital—through the joint stock system—make possible the provision of more and more extensive assemblages of plant and machinery. Mechanisation moves on faster and faster towards a goal that seems to be nothing less than the complete elimination of man's physical strength as a factor in the productive process. "From coal heaving to button pressing" seems to sum up the industrial odyssey of the modern world.

The Limits of Human Strength Removed. In this swiftly advancing mechanisation of industry there are three distinct, though closely related ways in which human labour is being transformed and replaced by the development of mechanical power. In the first place the limits set to productive capacity by the physical strength of the individual have been almost completely transcended. The weight that a machine can lift or the pressure that it can apply bears no relation at all to the physical strength, individual or collective, of those who manipulate its levers. A modern drop-hammer or mechanical crane is not merely a substitute for human energy: it is an individual force which no amount of such energy—not even the massed human strength that built the pyramids—could supply. As technique improves, this new force can be applied on an ever-increasing scale. It is the very foundation on which modern methods of production in the heavy constructional industries have been built up.

The Supersession of Skill. Secondly the machine serves as a substitute for the skill and dexterity of the human worker. It carries out automatically and with a constantly improving accuracy countless jobs which had previously to be done by repetition workers whom only long practice could make perfect. By this means the required period of training for work of this type is immensely shortened, and unskilled labour becomes far more readily interchangeable from one mechanical task to another. At the same time, as machines grow more delicate and complicated, they can be used more and more to replace not merely human dexterity but the superior and more painfully acquired skill of the trained craftsman. For example, in the making of machines improvements in the processes of casting iron have eliminated a large part of the old skill not only of moulders in sand and pattern makers in wood but also of fitters and turners in the later processes of machining and adjustment. Skilled labour does not cease to be needed—indeed in some branches of engineering work, such as tool making, and the repairing of machinery, there may be a call for even higher skill than before. But in every highly mechanised industry the proportion of highly skilled work to the total volume of employment is being greatly and swiftly diminished. Nor is the machine content to stop short at the processes of production. It invades the office and the counting house as well. The typewriter and the calculating machine have revolutionised the work of the clerical and administrative departments of modern business; and even the private home—last resort of the old manual drudgery—can be revolutionised as well as soon as the supply of domestic servants and the unpaid labour of working-class housewives ceases to be available.

It is true, on the other hand, that the new machines have often called into being new types of skill, and have sometimes resulted in replacing unskilled by skilled labour. The coming of modern mechanical engineering destroyed the traditional craft of the millwrights, who made the old machines out of wood; but it created the new skilled crafts

of turning, fitting, drop-hammer forging and a host of others. Again, the coming of the factory system in the spinning of textile yarns replaced the "domestic" workers of the old hand spinning processes by the highly skilled mule spinners of the nineteenth century. But in more modern times mule spinning has been giving place to the far less skilled process of ring spinning; and the skilled work of fitters and turners is being more and more taken over by standardised casting and forging and by automatic and semi-automatic machining processes. The nineteenth century to a great extent created new skilled crafts in place of those which it destroyed. The twentieth century is going much further towards the transference of skill from the worker to the machine.

The Displacement of Labour. Thirdly, modern machinery not only dispenses more and more with the need for either physical strength or manual skill, but also goes further towards the positive displacement of labour. If a machine can be made as skilful as a man and as powerful as the combined labour of many men, the number of workers required for putting a given quantity of energy in motion can be reduced to a mere fraction of what it used to be. Anyone who visits, for example, a modern flour mill will see how far this sheer elimination of labour can be pushed in an industry readily amenable to mechanisation.

Bring the grain alongside the wharf in the ship that has carried it from overseas. Stick a long pipe, equipped with powerful suction, into the ship's hold and with it suck the grain up to the top storey of the mill. Have the mill filled with automatic machines which separate, grind, sort and grade the grain, now becoming flour, as it descends automatically from floor to floor, until it is packed automatically into sacks and dropped into lorries which will bear it away to wherever it is wanted. In all this sequence of processes no human hand need touch the grain or even the machines that are at work upon it. There is no labour at all left save

that of a few crane-men, a few mechanics to oil the machines and keep them in order, and perhaps a worker or two with broom and swab, looking strangely out of place, to keep the mill swept and garnished. This is an extreme instance ; but it is the end towards which all mechanised industry seems to be moving by an irresistible momentum. To replace and amplify man's physical strength, to replace and improve upon man's manual skill—these are not enough. The end of industrialism is to make the worker a merely incidental and rarer and rarer attendant upon the machine.

In the latest development of industrialism the emphasis has been more and more upon this absolute displacement of labour. Indeed, the stronger working-class organisation and the working-class demand for higher wages and better conditions become, the greater grows the pressure upon the employer to dispense with labour and use machinery instead. While unskilled labour was cheap, emphasis was laid largely on enabling unskilled men and women to do skilled men's work—as it is still in India and China. But in America and Western Europe industrialism has passed beyond that stage. For there are no longer any dirt-cheap reserves of helpless and unorganised workers to be exploited ; and both skill and wages are relatively high. In these circumstances the obvious way of lowering costs is to get rid of labour altogether, or at least to use far less of it ; and especially in America and Germany this form of rationalisation has been pushed of late to astonishing lengths.

The revolution in the relation between human labour and production has, however, by no means been confined to manufacturing industry. As the nineteenth century advanced, the conditions of world agriculture were no less revolutionised by the opening up of the New World. The new phase was marked at first not so much by improved methods of cultivation or stock breeding as by the utterly changed conditions for the transport of agricultural produce. Railroads opened up the interior of great continents in America and Australasia ; and with every decade steam ships brought the new supplies of grain and other produce

more cheaply and in rapidly growing quantities to the old world from the new. Wheat came first ; but from the 'seventies, with the introduction of refrigeration, the ranches of America and Australia were able to supply the old world with a growing proportion of its meat as well. Great Britain as the richest country, with the best and cheapest manufactures to offer in exchange for food, became the principal market for the agriculture of the New World ; and under her free trade system her own agriculture was gradually contracted and a new movement of rural depopulation, which found its outlet in emigration to the New World as well as migration to the factory towns, set in. In terms of product per acre the new prairie lands could not compare with the highly farmed agricultural lands of Europe ; but in cheapness the virgin soils of the New World had the advantage, and low farming with little labour paid best where men were few and land cheap.

The conditions of agriculture in the new countries thus gave an impetus to mechanisation. The farm tractor, the mechanical reaper-binder, and the other power-driven instruments of modern large-scale agriculture became the characteristic tools of the prairie farmer. Farming in the new areas also gave a stimulus to scientific advance in the selection of varieties of grain and stock that would thrive under various climatic conditions, and in the fight against insects pests and diseases of plants and animals in every part of the world. Scientific research greatly increased the yield of cultivation, improved the weight and quality of stock, and enabled goods to be transported long distances with less and less deterioration. It improved the quality and yield of wool, devised uses for waste products such as offals, and guided agriculture in supplying the needs of industry for new types of produce. Again and again it was prophesied that agricultural prices were bound to rise in relation to the prices of industrial goods, because agriculture could not possibly emulate the mass-production methods of modern industry. But this did not happen : indeed on the whole the tendency was the other way.

Over the past century the revolution in agriculture has fallen no whit short of the revolution in industry. The " law of diminishing returns "—that constant terror of the economists and politicians of the early nineteenth century—is further off than ever it was from starving the human race. The world is complaining to-day not of a shortage but of a glut of agricultural goods, despite the survival over a large part of its surface of peasant cultivation at a very low standard of efficiency ; and Russia with her gigantic plan for the collectivisation of the whole of her immense countryside promises within a few years a further huge increase in the world's supply of agricultural produce. Not that the world ought to be in any fear of a glut of food ; for there are still among its inhabitants hundreds of millions who have far too little to eat.

The Growth of Specialist Agriculture. The newest agricultural methods tend, however, equally with the newest methods in industry, to the displacement of human labour in the raising of staple crops ; and this is especially true in some of the older countries which are being driven back to less intensive farming methods in their endeavours to cut down costs. But this tendency is to some extent offset by the growth of specialist forms of agriculture, such as the raising of market garden produce, fruit, eggs and poultry by more intensive methods for the supply of the growing urban populations. The development of these types of agriculture, so successfully pursued in Denmark and Holland, depends on a continued rise in the world's standard of living ; for the products of specialist agriculture belong largely to semi-luxury types. This ought not to stand in the way of their growth ; for clearly the world can afford to consume as much as it is able to produce. But it does mean that the growth of specialist agriculture depends on the maintenance of industrial prosperity. For if the industrialists cannot market their goods standards of living fall, and the demand for fruit, vegetables, eggs, poultry and almost all the more specialised kinds of farm produce

is diminished. The maintenance of population in the rural areas has thus come to depend on the continued advance of industry; and a fall in industrial employment involves a contraction of rural employment as well.

The Dilemma of To-Day. Taking the past century as a whole, economic advance has consisted above all in the steady decrease in the amount of labour needed to produce and deliver into the hands of the consumers a given quantity of goods. This tendency alone has made possible the great rise in the standard of living in every country which has adopted the new methods of production; and it is wholly good as long as it is so applied as to achieve this result. Throughout the century between the Napoleonic Wars and the Great War of 1914 it did, on the whole, work out in this way, although there was from time to time serious friction in the transference of labour from old to new types of employment, and certain bodies of workers, such as the hand loom weavers, were left derelict by the process of industrial change. On the whole it was possible to use increased productivity for the improvement of the standard of living, partly because the changes in industry, swift as they appeared to our ancestors, were in fact far more gradual than similar changes are to-day, but still more because the rapidly expanding world market enabled the advanced countries to increase their production for export, and because this foreign demand was further stimulated by the growing export of capital to the less developed areas. But of late the export of capital has suffered a check, and world demand has failed to keep pace with the expansion of productive capacity; whereas the displacement of labour through mechanisation has been going on faster than ever. There has therefore arisen an apparent deficiency of consuming power in relation to the capacity of the productive system; and the world's most pressing problem has come to be, not a further increase of the power to produce, but the devising of means for the full use of the productive resources already at hand. This problem has become

the more serious because the various countries, in their endeavours to find an outlet for their surplus goods, are seeking to expand their exports by cutting down their costs of production, and are in this way further decreasing consumption in their home markets. Nor can they easily avoid doing this ; for, if other countries do it and they do not, they are in danger of losing their export trade, and therewith the power to buy even necessary imports. But, the more they do it, the more unemployment increases over the world as a whole ; for the chief means of reducing costs nowadays is the absolute displacement of human labour. It may seem to the technician as if the manual worker were becoming more and more superfluous as an agent of production ; but if he is not allowed to produce how shall he be given the means to consume ? And unless he is allowed to consume, how shall the vast productivity of the modern economic system be successfully employed ?

CHAPTER IV: THE ECONOMIC SYSTEM IN THEORY AND PRACTICE

§ 1. THE SCOPE AND PURPOSE OF ECONOMICS

THE PURPOSE of this section is to undertake a broad survey of the actual organisation and working of the modern economic system, chiefly as it exists in the more advanced industrial countries, and of the theories which economists have put forward by way of analysis and explanation of it.

If this survey is to be realistic it must be based on real things and forces, and not on the forms in which men have chosen to organise these realities. We shall need of course to study the forms of organisation—indeed that is the main object of our survey—but we shall have to base our enquiry firmly upon the real things and forces which underlie the forms of organisation and control.

The Sources of Productive Power. There are only two sources of productive power—men and things—and both these sources are limited in supply. They are *scarce* in the sense that productive power, vastly as it has increased, is still finite. If the productive capacity of a man or a thing is applied to one purpose, the same capacity cannot be applied to another, at any rate at the same time. Something has been taken away from the available quantity of

productive resources and used for a definite productive end. The object of a sound economic system is to put the available resources to the best possible use—so as, in the phrase of the economists, to realise the *maximum utility*.

Man as the source of productive power has two capacities. There is first his power actually to labour at making things or rendering services either as a manual or clerical worker or as a technician or expert or administrator of some sort. But there is embodied and applied both in these forms of actual human labour and in the material resources upon which they are employed the accumulated knowledge of all the centuries of human history. This knowledge must be in the minds of men, or in the books and monuments which men have created ; but it is in itself something distinct from the actual labour currently applied to production. It is man's economic heritage—the inherited and constantly growing tradition of a whole civilisation—and it should be open to all the world alike if wealth is to be created in the greatest possible abundance.

Things as sources of productive power have also two aspects. There are first the things that are simply given to man by nature—earth, air and water, natural fertility and mineral resources, the productive values of climate as it acts upon men and things, seas and rivers and nowadays air as means of transport and communication, and water as a cleansing and moving power. But there are also the productive things which men have made by applying their minds and labour to these natural things—the existing implements and instruments of production, the real created capital embodied in mines, factories, warehouses, machines and the host of other things useful not in themselves but because they can be used in the production of something useful in itself.

The problem of economic organisation is to get all these sources of productive power used to the best advantage. It is, fundamentally, the problem of so applying the available resources of men and things as to produce the goods and services that are most wanted in the right proportions

and with the minimum of effort. This is *the* economic problem ; and fundamentally there is no other. It is not of course the whole human problem ; for men are not prepared to work always as hard as they possibly can. Man is not only a source of productive power. He is also the sole enjoyer and beneficiary of his productive efforts ; and he must have both leisure to enjoy and conditions of work which will not mar his enjoyment. Ultimately a decision has to be made between more leisure and more production, and concerning the intensity with which men are required to labour while they are engaged in production. But this is not a purely economic question : it has to be decided by weighing economic against other considerations. From the standpoint of Economics the available productive resources are those which men, in making this decision, decide to apply to productive uses. One of the greatest benefits of improved productive power is that it gives men the chance of more leisure as well as more material wealth.

Non-Economic Goods. The problem of the conditions of labour sets a further limit beyond that of the duration or the intensity of work to the use of the world's productive resources ; for some methods of production may be so irksome to the producers that it is desirable to forgo the additional material wealth that could be created by their exploitation. It is necessary to consider not only how to produce goods with the least possible expenditure of effort but also how to make this effort as little irksome and unpleasant as possible. But this again is not purely an economic question : it too has to be decided by weighing economic against non-economic values and disvalues. Moreover, work of certain kinds can be a positive source of pleasure. It may be worth while to retain such work, even if more material wealth could be created by other means. While the world is still struggling with the problem of poverty it is usually not inclined to pay much attention to these aspects of economic life—at any rate beyond excluding certain

processes that are highly dangerous to life or health. But, as the standard of living rises, the human race is likely to become more and more particular about the quality as well as the quantity of the work it does ; and here again it will be weighing economic against non-economic values.

The economic problem, thus defined, is of course not wholly for the economist to solve. It is even primarily a problem for technicians rather than economic theorists ; for the technicians who are expert in the various branches of production are the only people who can tell how to produce things with the minimum use of productive resources and of human effort. It is for them to devise and apply, as their knowledge grows, more and more efficient means of production, transport and service, so as to get the same amount of things men need at less real cost, or more of them at the same cost. This is not fundamentally a question of money costs, but of the actual labour and things used up in production. These are all technical matters which the economist has to observe and reason about, but cannot devise or initiate. For him the technical efficiency of industry and agriculture is a *datum* ; but he is entitled to take it as a *datum* not static but in the present age essentially progressive. He is entitled and compelled to assume that technical efficiency will continue to advance.

It is then the business of the technicians, including the research workers and scientists who stand behind them, continually to devise more efficient means of production ; but it is not their business to say what shall be produced. On this matter also their counsel is of course essential ; for they alone can tell what the real costs of producing this or that thing are likely to be—what savings in cost can be made by reducing the number of varieties of a particular sort of goods, and in what branches of production an increase of output is likeliest to bring costs down. All these are guiding considerations for the consumer and upon them all he needs the advice of the technicians ; but what things are to be made and in what quantities are the affairs of everybody, because everybody is a consumer, and all final

products are made only to be enjoyed. Even the decision what kinds of machines and other instruments of production are to be made is in its non-technical aspect a matter for the consumer; for the need for such things depends on the need for the final products which they can be used to create.

The Consumers and their Wants. The needs of the consumers, which thus appear to be the final regulators of production in any well ordered economic system, can express themselves as either individual or collective demands. The individual housewife or other buyer may ask for such and such a thing at a shop or wherever goods and services are bought and sold; or the State or a municipality or some other collective body may order a supply of goods and services on behalf of the citizens or some group among them. Some goods and services, such as roads, parks and other public amenities, are of such a kind that it has been found most convenient for public bodies to supply them free of charge, and thus act in ordering their production as the interpreter of the consumers' needs. It is a matter for argument how far this type of free supply ought to be carried. It has hitherto been invoked mainly with two objects—either, as in the case of the turnpike roads, because the making of a charge obviously interfered with the efficiency of the service rendered, or in order to give poor people necessary services which they would not otherwise have been able to afford.

In as far as demand is merely a matter for the consumer, who expresses it by offering a price for the goods he wants, and in as far as the methods of production are merely a matter for the technician, who devises and applies the best instruments for meeting the consumers' demands, the function of the economist would seem to be simply that of an observer watching the operation of these forces and explaining how they work to anyone who has curiosity enough to want to know. There are indeed some people who would like to reduce economics to this purely passive

rôle ; but the matter is not in fact in either of its aspects so simple as this. For on the one hand production has to be organised as well as technically directed ; and this organisation raises all sorts of problems which are not affairs of technology or applied science. And on the other hand the things which consumers demand depend on the prices asked for them and on the amount of the incomes in the consumers' hands ; and the regulation of prices and incomes involves difficult problems in the ordering of the economic life of society in the distributive sphere. The province of the economist lies mainly between these two groups of problems. He is concerned with the best ways of organising production and distribution within the conditions laid down by the technical development of productive power on the one hand and by human wants on the other.

At this point, however, an obvious difficulty arises. The technical development of productive power is a definite thing which sets limits to the quantities and kinds of goods that can be produced. But the conception of human wants has no such clear and definite character. For the actual demands which consumers make are conditioned by the sizes of their incomes and by the prices charged for the different classes of goods and services ; and, unless the economist is to accept the existing distribution of incomes and the existing methods of fixing prices as absolute and unquestionable *data*, he must go behind them for his conception of human wants and appraise them in the light of their adequacy in meeting these wants. It is certainly not the economist's business to lay down what people ought to want, or to make his own ideas of what people need his standard of judgement ; but he cannot avoid going behind demand as it is to demand as it would be if the relative prices of different goods were altered or the existing distribution of incomes changed. He must have some standard by which to criticise the working of the economic system ; and any such standard must involve a judgement about human wants.

The standard usually proclaimed by economists is that

of satisfactions. The object of the economic system, they tell us, is to produce and distribute the greatest possible amount of *total utility*, and utility is to be measured by the amount of satisfaction received by the consumers. They go on to explain that in the case of most goods and services the more a person has of a thing the less satisfaction an additional supply will afford. It follows from this that a given total of production is likely to yield the greatest total satisfaction if it is distributed equally among all consumers, not in the sense of giving each consumer an equal amount of every commodity—for tastes differ—but in the sense of allowing them all to draw from the common pool equal totals of goods, each choosing what he wants most at the valuation placed upon it. It would therefore seem from this point of view that the only way of achieving the maximum total utility would be to give every member of the community an equal income—that is to say, an equal claim on the pool of goods and services. For any inequality of incomes will be likely to result in some things being so consumed as to yield less than the greatest possible utility.

Production and Distribution. But in fact the systems of production and distribution of wealth are not separate. Incomes are distributed under existing conditions not only as means of consumption but also as rewards for and incentives to production. It cannot therefore be taken for granted that equality of income would result in the greatest total utility; for it might react adversely on the quantity of things produced. Indeed the traditional defence of inequality, as far as it is defended on rational grounds, is that equality of incomes would so lessen the total amount of production as more than to offset its beneficial effects on the satisfaction derived from consumption. Nor can there be any doubt that this view is correct if the existing system of economic organisation is taken for granted. For production at present depends on incentives which clearly involve a considerable degree of economic inequality. The question is whether it is possible to devise an economic

system which will secure at the same time maximum production and maximum utility in the consumption of the things produced.

The fact, however, remains that the standard laid down by the economists—the standard of maximum utility—sets up a strong presumption in favour of equality of incomes, and that accordingly it is desirable, if it can be done without loss, or without too much loss, in total production, so to organise the economic system as to approach as nearly as possible to equality in distribution.

This standard of maximum utility or satisfaction to the consumer is commonly so stated as to imply that the consumer is the best judge of what he wants. Over a large part of the field this is undoubtedly true ; but, as we have seen, demand can be collective as well as individual, and individual demand is always influenced by the relative prices charged for different things. Where demand is collective, the collective body sets itself up as the judge of what the consumer needs—not precisely of what will satisfy him most as an individual, but rather of what will best promote the largest general amount of satisfaction. For by abstaining from certain goods—such as soap and water—a man may cause far more dissatisfaction to his neighbours than satisfaction to himself. Somewhat similar considerations arise in certain cases in which States intervene in order to make some particular kinds of goods cheap or dear, and so encourage or discourage their consumption. The standard of judgement in these cases is usually not the satisfaction of the individual consumer but the effect of more or less consumption on the amount of satisfaction in the community as a whole. If a man consumes too much alcohol and too little education he may both impair his productive capacity, of which the community has need, and be a nuisance to his friends and neighbours. In either event the effect of his action is to diminish the total of satisfactions.

It is, we have said, not the economist's business to decide, though he may advise on economic grounds, what services ought to be given free, what goods priced cheap or dear,

or what things ought to be produced in greater or smaller quantities in order to afford the maximum satisfaction. These are matters for the consumers, individually or collectively, to decide for themselves. But it is the economist's business, starting from a presumption in favour of economic equality, to study how the system of production and distribution can be so arranged as to make it easy for the consumers to secure the maximum of satisfaction. He has always to be asking how far any existing inequality is really necessary in the interests of production, and how far the need for it could be lessened or removed by alternative methods of economic organisation.

§ 2. THE PRODUCTIVE SYSTEM

WITH THESE preliminaries in mind we are now in a position to approach the study of the system of production with a clear idea of the purposes which we have in view. This system consists fundamentally of the available productive resources—men and things—organised in certain ways. The resources themselves, as they exist, or rather as they are being developed, are for the economist *data*—things given by the size and equipment of the population, the natural resources and the accumulated real capital at command, and the state of human knowledge. But these *data* are not fixed but constantly changing. Populations can rise and fall, and their equipment be worsened or improved. Natural resources can be exhausted or renewed according to the ways in which they are exploited, and what is useless for production to-day may become useful to-morrow through an advance in knowledge. Real capital—factories, machines, railways and a host of other things—is always wearing out ; and it is at men's discretion how far to replace it with new capital goods of the same kind or of different kinds, and how far to increase the total equipment of the productive system. Knowledge is always growing and

is being applied in a thousand new ways to the use of the available resources within any continuously developing civilisation. Some of these *data* are indeed outside men's control. They are *data* for the community as well as for the economist ; but most of them can in some degree be controlled by men's collective or individual action.

Thus, the numbers of the population are susceptible at any rate to control by the individuals who make it up ; and the action of the individuals can be influenced by that of the State in giving to them or withholding from them certain forms of knowledge. The material equipment of the community is subject to both collective and individual control. The use or abuse of natural resources and accumulated capital, of human labour, and of technical knowledge, are all controllable in some degree. The accumulation of new capital can be controlled both as to its amount and as to the specific capital goods to be made. And nearly all these controls can be exercised in some measure by the State or by other public bodies, or left wholly to the action of individuals or private corporations and associations within the framework of a particular economic organisation. This framework is, however, of vital importance ; for upon it depends to a great extent how the individual and private controls will be applied. Even the most individualistic society cannot in effect leave control wholly to the indidual ; for, if it is a society at all, it cannot help laying down the rules within which the individual controls are to operate.

The economist's practical function is then that of advising about the forms of economic organisation best calculated to ensure the use of the technical powers of production for making and distributing in the most satisfactory way those goods and services which are in individual or collective demand. His province is essentially that of economic organisation in the widest possible sense of the term.

The real problem of production, as we have seen, is to secure the full use and right apportionment to different industries and services of the available productive resources —men and things. With this fundamental objective in

mind let us see how these matters are cared for under the economic system of to-day.

Under-Production. We have noticed already that the present system fails to secure anything like a full use of the available resources. Let us leave aside, for the time being, the voluntary abstention from production of a small class that prefers to live in idleness on unearned incomes—incomes which the economic system allows it to receive. This class is of course very much smaller than the whole class which is in receipt of unearned incomes ; for the majority of persons who get such incomes also do some kind of work. Apart from this voluntary idleness, there is ample evidence in involuntary unemployment and disuse of capital resources that the available powers of production are not being fully employed. This is the case to a quite unusual extent to-day in consequence of the world slump. But always, even in the most prosperous times, there is a substantial amount of unemployment, and some capital resources are lying unused.

Why does this happen? Because those who control the existing capital resources and the means of making new ones do not see their way to using such resources to the full under conditions which will permit them to make a worth-while profit by their use. They accordingly leave capital resources or the means of making them unused ; and unemployed labour follows as a result of this abstention. In other words, under the present system most branches of production are organised on a basis which involves the disuse of productive resources unless they can be used at a worth-while profit. The prospect of profit is the pivot on which by far the greater part of the economic system turns.

This does not mean that no production is ever carried on except in the expectation of profit. It may suit a firm better to take on a contract or to keep a factory running for a time at a loss than to close down. But this will occur only if there is an expectation that profits will be obtainable

again at some later time. A State or municipal enterprise, or one in receipt of a public subsidy, may indeed be run permanently at a loss ; but it can be so run only because the public body is able to levy taxes, and unless profits were being made in other industries and services the sources of taxation would speedily dry up.

This dependence on profit as the incentive to production is not peculiar to modern capitalist enterprise. It exists wherever production is carried on under conditions too complicated to admit of the producer living by the consumption of his own product or by direct barter. The peasant producer can often in the last resort eat his crop instead of sending it to market ; and consequently he may continue to produce even when he cannot make a profit by the sale of his products. But the industrial producer, whether he works on a large scale or a small scale, must sell or exchange his products in order to live at all. Save to the small extent to which he can resort to direct barter, he cannot go on producing unless the sale of his products yields him a surplus over what he has to spend on their production. The new circumstances introduced by modern industrialism are, first, that it has caused a far larger part of the world's population to depend for its living on the sale of industrial products, secondly that it has in part industrialised agriculture and so made production by peasants and farmers as well as in industry depend largely on the prospect of profit, and thirdly that it has turned the great majority of industrial producers into wage-workers, so that not their prospect of profit but that of the owners of the instruments of production has become the decisive influence on the quantity of goods produced.

The Pivot of Capitalism. It is indispensable to seize firmly at the outset this pivotal position of profit in the modern economic system ; for until this is understood the world's failure to make adequate use of the productive resources at its command seems merely absurd. It is inconceivable that it should really be of advantage to the world

to leave a substantial part of its productive power unemployed ; but it is quite intelligible that the owners of a particular mine or factory should be unable to make use of it so as to realise a profit, and that unemployment of wage-workers should result from this inability.

Under the system known as private enterprise profit is the only possible means of getting goods and services produced ; for all other forms of income, though they are equally the means of living to their recipients, make their appearance in this system as costs and therefore as deterrents and not incentives to production. It is true that monetary incentives may be offered to wage- and salary-earners in order to induce them to increase their output ; but whether their doing this will result in increased production or a diminished volume of employment depends on the prospects of profits as estimated by their employers. Profit remains the pivot on which the entire system turns.

We shall have at a later stage to consider the advantages and disadvantages of this pivotal position of profit ; but for the present I am trying only to get the essential features of the present system clear in the minds of my readers. Modern industrial production, and to a considerable extent modern agriculture as well are carried on with the aid of a large and expensive equipment of capital goods—buildings, machines, sources of power-supply, and so on—which embody a large initial expenditure of productive resources. This equipment is constantly wearing out and needing to be renewed ; and some of it is constantly being made obsolete by new inventions or other changes in the technical requirements of industry, or in the nature and direction of consumers' demand. Moreover, if the world wishes to live at an advancing standard of life and to take advantage of the continual possibility of expanding production, or even if it wishes to increase its population without lowering the standard of life, it must do more than merely replace its capital equipment as it wears out or becomes obsolete. In other words it must always be applying enough of its current productive resources to the making of capital goods

to ensure the required expansion in the output of consumers' goods.

There is, of course, no fixed limit to the amount of new capital which it is desirable for a community to accumulate; for all such capital can be used to improve the standard of life. But there is a *relative* limit; for enough must be spent to absorb the supply of consumers' goods which the capital equipment is able to produce. Otherwise the saving will be sheer waste. Where consumption does not rise in proportion to saving there is bound to be an economic crisis, unless the country in question can meet the difficulty by constantly increasing its investment of capital overseas, or in other words, constantly sending its surplus products abroad without receiving any equivalent in imports.

But the export of capital, while it may temporarily solve the problem for a particular country, clearly cannot solve it for the world as a whole. Over the whole world, unless a crisis is to arise, consumption must increase fast enough to absorb all the products which the capital goods created by saving are able to produce. But in capitalist countries no such collective decision is made in terms either of real productive resources or of money. The amount of saving and spending in the community as a whole is the result of an infinite number of separate decisions made by individuals, business firms and associations, with little or no element of collective regulation. In each country each individual recipient of income who has a surplus over his bare needs decides for himself whether to save any of it or not. Each separate business decides, if it has made a profit, how much to distribute in dividends to its shareholders, and how much to accumulate by placing it to reserve. It is at the discretion of each business to make or not to make adequate provision against depreciation and obsolescence of its equipment. And a host of non-trading bodies, such as colleges, Friendly Societies, Trust Funds and the like, decide for themselves whether to spend up to their incomes or to build up reserves for the future. The sum of all these individual and group decisions makes up the total saving and the total

spending of the community. What these totals are can only be guessed or estimated, and cannot be accurately known. There is no collective attempt to secure by organised action a right proportion between the two.

This does not mean that the amount of capital accumulation is simply the result of a vast number of unpredictable and purely capricious individual decisions. Obviously there is in it a large element which depends on the psychology of the individual—on the extent to which he looks to the future, or, on the other hand, reckons a bird in the hand worth two in the bush, on the degree of confidence he feels in the security of his savings and in the stability of the economic system, and upon his sense of responsibility for his dependents. But these factors are themselves largely external to the individual. The habit of saving is far more deeply rooted in some communities and classes than in others. The sense of responsibility for dependents is influenced by the character of the provision publicly made by the State ; and the degree of confidence in the security of savings and in the stability of the economic system depends upon, as well as influences, the movement of events.

Saving and Distribution. A further factor which vitally influences the amount of saving is the distribution of incomes. In modern industrial societies, with their great inequalities of income, the great mass of capital accumulation comes from the richer classes, who have incomes larger than they feel any desire to spend. The savings of the middle classes are also important, and far more stable from year to year, while working-class savings vary greatly according to the prevailing degree of industrial prosperity. If the same total income were more evenly distributed without any other change in the economic system, the amount of individual saving would probably be smaller, but more constant from year to year ; for the conditions of middle-class saving would tend to reproduce themselves over a larger part of the population.

The savings of the rich come to a great extent out of

income which they feel no desire to spend, and are to that degree automatic. But this causes them to vary greatly in good and bad times. For when times are bad the rich, like the working-classes, have less surplus income over their estimates of what they need to spend. Middle-class savers, on the other hand, are often saving by means of insurance policies or house mortgages carrying a fixed premium, or in order to provide for some definite future need such as their children's education or an annuity on retirement. They tend, therefore, in bad times rather to restrict their spending than their saving as their incomes fall off. These conditions apply in part to working-class savings as well, but not enough to offset the extent to which past savings are liable to be swept away by unemployment.

The amount saved in the community is therefore largely a function of the economic system as it is, and depends on the way in which incomes are distributed. But by no means all the money saved becomes capital for the development of the productive system. Group savings placed to reserve out of profits by industrial concerns are indeed largely turned into new means of production ; and their amount varies a great deal from year to year in accordance with the success of businesses in earning profits. But individual savings have other possible outlets—in loans to Governments, which may or may not be productively used, in stock exchange speculation, or simply in leaving money on deposit in the banks. Moreover, both individual savings and the group savings of corporate bodies can be invested or lent abroad as well as at home.

Saving and Investments. The application of new capital to the development of the community's productive resources does not therefore coincide with the amount of savings, although saving is the only source from which this new capital can come. Under the existing conditions the volume of new capital invested in industry, like the volume of current production, depends primarily on the prospect of profit. Those who have money available to invest will

invest in industry if they see a prospect of sufficient profit from the investment. But if in their view the prospect of profit is not good enough they will not invest even money which they have saved, but will prefer to apply it to other uses or even to leave it in the banks until better times return.

Within the existing structure of industry there are broadly three ways in which capital can be applied to the development of production. This can be done by the method of accumulating profits as reserves, instead of distributing them as dividends to shareholders, and by the use of these reserves to provide additional equipment or working capital. Or it can be done by means of investment by individuals in the preferred or ordinary or common stocks and shares of joint stock companies or corporations. Or finally it can be done by lending to such companies or corporations by way of debentures or loan stock of one sort or another. In the first case the new capital goes to enhance the market value of the existing shares by earning for their owners a higher profit. In the second case also the yield from investment takes the form of a variable profit dependent on the fortunes of business, or in the case of preferred stocks or shares of a limited dividend payable only if profits are earned. On the other hand in the case of loans and debentures the borrower contracts to pay interest at a fixed rate whether he makes a profit or not. The investors who lend money in this way do not become part-proprietors of the business but creditors ; and the business is in their debt for interest and principal.

When a person invests money in stocks and shares he does this in the hope of profit. When he lends by way of debenture or loan stock he is able to do this because the borrower hopes by use of the money to make a profit over and above the interest which he contracts to pay. Thus the demand for loans for business purposes depends on the expectation of profit ; for the hope of profit is the inducement which makes the borrower agree to pay interest. If, in general, the expectation of profit is low, less money will be invested in

preferred and ordinary or common stocks and shares ; but less will be lent at interest too, because business men will be less inclined to borrow. Although interest and profit are radically different forms of income, and interest ranks in the minds of the business man as a cost and profit as a gain or surplus, the flow of the two forms of capital into industry is closely connected, and depends finally in both cases on the expectation of profit.

Here again we find the anticipation of profit in the mind of the business man occupying the pivotal position in the economic system, by determining—not indeed the amount of saving—but at all events the rate of capital accumulation in industry. For higher profits both provide a larger amount of surplus income out of which savings can be made, and induce the possessors of this surplus to invest or lend it in such a way as to cause it to be spent on additions to the productive resources of industry.

The Profit Regulator. The level of profits is accordingly regarded by many economists as an automatic regulator of the relative amounts of saving and spending, or at least of the relative proportions of the available productive resources used for making producers' and consumers' goods. For, if profits rise and the rate of capital accumulation is increased, it is held that the consequent increase in the supply of goods will tend to bring down prices, and with them profits, until the balance is restored ; whereas if profits fall too low to induce sufficient accumulation there will arise before long a scarcity of goods, which will cause prices and profits again to rise. This is part of the theory of an automatic tendency to equilibrium in the existing business system ; and at a later stage we shall need to ask how far this theory is true.

Meanwhile, we have reached the point of seeing that both the volume of current production and the rate of accumulation of new capital in industry depend on the prospects of profits, as these are interpreted by the persons who control production and by those who have money to

invest. Under these conditions a fall in profits is bound to result in both decreased production and decreased accumulation of capital, and therefore in unemployment both of productive resources in men and things and of money which would otherwise be used for investment in industry.

We have, then, a volume of production determined mainly by anticipation of profit in the minds of business men, and a volume of developed productive capacity which is affected by the amount of profit made in the past and invested in industrial equipment, and also by the current anticipation of future profits. As far as the volume of production is concerned, the deciding factor is the state of opinion among business men, and especially among the heads of those large businesses which in the modern world largely settle how much of the leading commodities is to be produced. In some trades the amount of production is still quite unregulated and is simply the result of a number of decisions arrived at separately by different businesses. In others—for example, in the British coal trade and in many German industries—it is decided by the trade as a whole ; and sometimes the regulation of output has the sanction of the law behind it. Often firms are fined by their association for exceeding the permitted quota of output ; but whether there is collective regulation or not, the main determinant is the expectation of the amount of profit to be made.

Costs of Production. This profit, of course, depends not only on the quantity of goods sold but also on the differing costs of producing different quantitites, and on the varying prices which consumers are prepared to pay for a larger or smaller supply. Profit is a surplus of receipts over costs ; and costs per unit vary with the quantity produced. The more costs can be cut down, the more profit can be made if other things remain the same. How far the other things can remain the same, and how costs and demand are related, we shall have to enquire later on. For the present we are concerned only with the fact that decisions about the quantities of goods to be produced are made

by those who control the productive machine, either individually or collectively, in the light of their estimates of the prospects of profit, and are not made either by the consumers or by any body acting on the consumers' behalf.

It is indeed often stated that the consumers do, in the last resort, regulate production, because it is in their power to buy or to refuse to buy, and no one will go on producing what he cannot sell. But the consumers only decide what to buy when the prices of the goods offered for sale are already fixed ; for the chaffering of the Eastern Bazaar is by no means characteristic of the modern industrial world. To the final consumer most prices are fixed prices ; and the fixing is done by the producers or dealers, who thereby affect demand. These persons have, of course, to be influenced in their actions by their estimates of the amounts of the various goods which consumers will be prepared to buy at the prices they fix. But they are free to choose between selling less at a high price and more at a low price. They can either fix a price and then put on the market as much as they think they can sell at that price, or they can fix a quantity of output and then estimate the price at which it can be sold. Broadly speaking, if they fix the price the quantity follows ; and if they fix the quantity the price follows. But they, and not the consumers, have the greater part in fixing what the quantity sold shall be, whether they do this directly by determining output or indirectly by determining price.

§ 3. COSTS AND PROFITS

The profit with which business men are concerned is essentially a margin between costs of production and the prices at which goods and services are sold. The business man's object is therefore to bring his costs of production per unit down to the lowest possible point. It does not follow that his object is also to sell his goods at the highest

possible price ; for to do this would inevitably restrict sales, and might lessen his total profit. His concern is not with the amount of profit per unit of production, but with the relation which his total profit bears to his total costs and to the amount of his own or his shareholders' capital locked up in production. On some occasions it may suit him to raise prices, though this will cause him to sell less goods ; and this will be most likely where production is organised on monopolistic lines, or where the product is of such a kind that changes in its price have comparatively little effect on the quantity which can be sold. In other cases it will suit him best to reduce prices in order to expand sales ; and this will occur most readily where a trade is strongly competitive or where demand is likely to expand considerably if prices are brought down. Some goods, including the basic necessaries of life, are highly *inelastic* in demand—which means that within fairly wide limits price-changes have little effect on the quantity sold. Others, such as the less expensive luxury goods, which a great many people are on the margin of being able to afford, are highly *elastic* in demand, so that price changes have a big effect on sales. Other goods lie anywhere between these two extremes in respect of elasticity of demand. A monopolist who sells goods which are inelastic in demand is in the strongest position for raising prices. A competitive producer who sells goods for which demand is elastic is in the weakest position.

But there is a further factor to be taken into account. In most trades the quantity produced has a considerable effect on the unit of cost of production. Up to the point at which the factory is running at full-time and using its full normal equipment of power, machinery and labour, unit costs of production tend to fall as output is increased. This happens largely because there are many standing charges—for administration, upkeep of machinery, insurances, interest on borrowed money, and so on—which do not vary in proportion to the quantity of goods produced. If these charges can be spread over a larger output, cost per unit falls. These conditions apply over the greater part of

machine industry, but in very varying degrees according to the proportion which standing charges bear to the total costs of production. They do not apply to the same extent to less mechanised industries, in which wages form a higher proportion of total costs.

This is not to say that, even in the most highly mechanised industries, output can over a short period be raised indefinitely at a falling cost per unit ; for, if the business man attempts to turn out more goods than his factory is adequately equipped to produce without increasing his equipment, his unit costs will tend again to rise. He can indeed, by enlarging his factory or building a new one, usually bring down his costs lower still, especially where technical efficiency is advancing fast. But this will take time ; and he will not be prepared to sink capital in fresh equipment unless he expects the higher demand for his goods to be sustained long enough to recoup him for his outlay of capital. Obviously, in addition to the considerations mentioned above, the degree in which unit costs will be increased or decreased by contracting or expanding output, and the amount of new capital that will have to be applied in order to decrease costs, will be powerful factors in influencing the decisions of business men about the prices to be charged and the quantities to be produced. Even a monopolist will reduce prices if he can thereby sell more goods, and if his unit costs of production will be so reduced as to swell his total profit by enough to make any necessary outlay of new capital worth while. But usually business men will not be prepared to sink new capital in production in order to meet an increase in demand which they believe to be purely temporary.

The elasticity of demand varies not only from commodity to commodity but also from time to time ; for it depends on the amount of income consumers have to spend. If their incomes fall, a higher proportion has to be spent on necessaries and standing expenses, and there is less free margin left to be directed to this or that kind of spending by a fall in price. Accordingly business men are apt to try to hold

up prices in bad times because demand is then exceptionally inelastic.

The extent to which unit costs of production can be brought down by increasing output has been described so far as it applies to a particular productive concern, and not to a whole trade. Within these limits costs will tend to fall for any particular factory as output rises. But this may not be true of a whole trade; for the effect of expanding demand may be to bring into operation less efficient plants, managements and workers previously unemployed, and thus increased production may involve higher costs. This is most likely to occur when the rise in demand is a result not of lower prices but of higher incomes in the consumers' hands. It is a feature of periods of trade boom, in which rising demand both helps the most efficient producers to lower their costs and enables even the less efficient to produce at a satisfactory profit. At such times prices may be expected to rise, and the more efficient producers to make abnormally large profits as long as the boom lasts. Why such booms do not last for ever we shall have to enquire at a later stage.

Prices and Output. We have, then, a picture of business men, closely combined in some trades and still strongly competitive in others, deciding upon their policy about prices and output with a number of different considerations in their minds. The most important of these are, first, the varying elasticities of demand for different classes of goods, secondly the varying effects on costs and the varying amounts of capital needed as output is increased or diminished, and thirdly the size of the incomes in the hands of the consumers at the time when the goods are to be sold. Monopolists and competitive producers will regard these considerations from different points of view. For the monopolist it will be a question of discovering what quantity of production and what selling price will yield the best total net return, and fixing both—output and price—each in relation to the other in accordance with the

limits set by consumers' demand. Competitive producers, on the other hand, have no such control over the market ; and their action takes the form chiefly of deciding at what prices they are prepared to sell, and then producing as much as they think they can sell at those prices. If, however, they decide to make for stock they must be prepared to sell at what prices they can get. In some trades prices are largely standardised, and it is mainly a question of how many orders each producer receives—competition being in terms of quality and marketing efficiency rather than of price. In other cases there is keen competition in prices as well, except in times of boom when most factories are fully employed.

The growth of combination in the modern business world tends strongly to standardisation of prices on a national scale, and to the limitation of competition in terms of price ; for where strong combination exists the prices of standard articles are usually varied simultaneously by agreement over a whole trade. In the case of articles which cannot be so standardised, there remains some scope for price-competition ; but even this is often limited by agreements for interchange of information about contracts and prices, and even for pooling and sharing out of orders among the associated firms. Under these conditions, price-fixing tends to become more and more a function of the productive system, and less and less the result of any real haggle between producer and consumer ; for the modern business world is increasingly of opinion that higher profits are to be made in a regulated than in an unregulated market.

Even, however, where competition is severely limited, the producer does not lose his incentive to lower costs of production For, at whatever price and in whatever quantities he sells his goods, a reduction of costs is always in itself an advantage from the standpoint of the firm which makes it. " The lower the cost the higher the profit " is from the standpoint of the individual business man an obvious truth. It holds good for his own particular business

regarded in isolation, whether he is a monopolist or a competitive producer. Whether it holds good equally for the business world as a whole we cannot say until we have studied the interaction of the various parts of the economic system, as well as the conditions under which production is carried on.

Real and Money Costs. In general, however, economists appear to agree on this point with the business man. On a first view it seems perfectly plain that it is a good thing to reduce the costs of production, and that economic progress consists mainly in doing this ; for the great advance in the world's wealth is mainly due to success in reducing the real costs of production by using up less labour and other productive resources in making a given quantity of goods. But economic progress depends on the reduction of *real* costs reckoned in terms of the labour and other productive resources used up in getting goods made and delivered to the consumers. On the other hand, the cost which the employer wants to reduce in order to increase his profits is money cost, which is by no means the same thing. The business man of course has to pay in money for the productive resources which he uses up ; and money cost is thus related to real cost. But how are the two related ? Suppose the price of coal falls. The cost of producing steel falls with it, even if no less coal than before is used up in making a ton of steel. There has been in the steel-making process no reduction in real cost. There may have been a reduction in the real cost of getting coal, owing to better technical methods ; but equally there may not, for the fall in the price of coal may be due to quite other causes, such as depression in the coal trade leading to intensive competition among colliery proprietors. If that is the reason for the fall in coal prices there has been no reduction at all in the real cost of steel-making, however much the money cost may have fallen.

The case usually advanced in justification of the profit incentive in modern industry is that it gives each business

the strongest possible inducement to efficiency; for the businesses which are able to reduce their costs to the lowest point stand to make the highest profits, while the least efficient firms, which have the highest costs, tend to be squeezed out. By this means, it is urged, industrial progress is continually stimulated, and the steady improvement of productive technique assured. The employer is induced to manage his business as efficiently as he can and to be always on the look-out for new inventions and other means of reducing costs; and he is also impelled to pass on this stimulus to those whom he employs, both by selecting the best and discharging the worst workers and by offering the most persuasive inducements to higher output.

But unfortunately costs can be lowered not only by increasing efficiency, but also by reducing the incomes distributed in the course of production, or replacing dearer by cheaper labour. And the business man has, naturally enough, an ingrained habit of regarding wages as an element in cost which it is desirable to keep as low as possible in order to capture a wider market. The economists and his own "common sense" tell him that, the cheaper things are, the more of them can be sold; and of course there is sense in which this is true. If a thing becomes cheaper, *and consumers have still the same amount of money to spend*, the demand for it is likely to increase; but if the cheapness is the result of lower wages consumers will not have the same amount of money to spend, and there is no reason to expect a larger demand. Doubtless, if wages are cut and goods cheapened in one trade only, while conditions in other trades remain unaltered, that one trade will be able to sell more of its products. But if the process is extended to all trades or to most this is not likely to happen. The employer, used to thinking in terms of his own trade rather than of the economic system as a whole, does not readily take this view, and he is in any case inclined to argue that its truth would affect his action only if all employers were prepared to act together internationally. He feels safe therefore in leaving it out of practical

account. But the fact remains that competitive wage reductions are disastrous to world prosperity, and that a system which can find no means of preventing them is in serious danger of collapse.

Nor is this the whole of the problem. Modern power-driven machinery has brought high industrial efficiency within the reach of the more backward nations with their unlimited supplies of cheap labour. This ought to mean for the whole world a rapid advance in material prosperity ; and up to a point it will have that result in the long run. For it is bound to bring about a rise in the standard of living in these more backward countries. But for some time wages in these countries are likely to remain very low because of the unlimited reserve of half-starved peasants on which the growing industries will be able to draw. This supply of cheap labour will enable high profits to be made, and so speed up the pace of industrialism. But it will also involve destructive competition with the countries in which wage standards are relatively high. It is true that the less developed countries cannot become industrialised very quickly because of their shortage of native capital ; but as the possibilities of cheap labour working upon modern automatic machinery come to be more widely appreciated capitalists in the older countries are likely, if political conditions are sufficiently settled, to invest new capital more and more extensively in the less developed countries rather than in their own. This will worsen the situation in the older countries by increasing unemployment, and will imperil the relatively high wages which the workers in these countries at present receive. It will also intensify the demand for tariff protection, in order to maintain profits and investment in the developed countries.

Wages and Purchasing Power. The total volume of purchasing power is of course equally affected whether wage-rates are reduced or less workers employed at the old rates of wages. For, even if the unemployed are maintained out of public funds, the cost of their maintenance has to

come out of the incomes distributed in the productive process. It is not therefore an addition to purchasing power, but only a transference from one section of the community to another. It may, by transferring purchasing power from richer to poorer people, slightly increase the demand for consumers' goods ; but this effect is bound to be very limited, especially if a large part of the burden of taxation falls either upon the workers or directly upon industry. Rationalisation, therefore, if it causes " technological " unemployment, depresses the home market in much the same way as wage-cutting.

When, however, costs are reduced by rationalisation, instead of wage cutting, there is a fall in real as well as money costs of production. Goods are thereafter being made with a smaller expenditure of productive resources and not merely of money. This process, unlike the other, ought to be sheer gain ; for it ought to give men the choice between higher real incomes and more voluntary leisure. But actually it enforces idleness—which is a very different thing from leisure—upon some, and in many cases, though not in all, makes work harder and more intensive for those who remain in employment. It does not necessarily cause any expansion in the total volume of production—for that depends on the expansion of the market—and the initial effect of rationalisation is to decrease employment without proportionately raising wages, or reducing prices, and so to react on the volume of demand.

§ 4. THE PROBLEM OF DISTRIBUTION

This changes the direction of demand, though not necessarily its total amount. It results in decreased demand for consumers' goods and a higher proportion of " savings," which seeks an outlet in the purchase of capital goods. But as we saw an addition to the supply of capital goods is valueless unless consumers' demand expands proportionately.

Accordingly, while the fall in the real costs of production gives a temporary stimulus to industry and may produce a boom, prosperity due to this cause cannot be sustained because its continuance depends on high profits, and these result in an excessive supply of capital goods and a decreased proportion of demand for consumers' goods. Thus, as soon as the new instruments of production come into play, a deficiency of consumers' demand arises, and profits are again forced down.

This dilemma suggests that incomes are not only too unequally distributed at present, but also distributed by a radically wrong method. It suggests strongly that a system which treats only one form of income—profit—as an incentive to production, and all others as costs—deterrents to production—is bound under modern economic conditions to lead to disaster.

But what alternative is there to this method of distribution ? For wages, interest and rent clearly are costs of production to the employer ; and profits as clearly are not. It is not the employer's fault that he looks on the different forms of income in this way. He is the servant of the system and not its master. But to exonerate the individual employer from blame only throws more strongly into relief the criticism of the system itself. For it seems as if any economic system which leaves decisions about the amount and character of production to business men who are compelled to aim at making a profit must lead either to alternations of prosperity and depression, or, if the attempt is made to correct the mal-distribution of incomes by raising wages and taxes beyond a certain point, to depression permanent and unrelieved. This suggests that there is a radical defect in the entire arrangement which entrusts the control of production to a special class of private business *entrepreneurs*.

This is of course the Socialist view ; for Socialists have always insisted that " production for profit " is radically bad, and desired to substitute for it a system of " production for use." They have contended that the community

itself ought to assume through its appropriate economic organs the functions both of deciding how the available productive resources are to be used and of distributing incomes in such a way as to balance the supply and demand for goods and services. To do this would involve, as we have seen, a collective allocation of productive effort as between capital goods and consumers' goods, and a corresponding allocation and regulation of purchasing power. It would mean that "saving" as a source of capital accumulation would become a collective instead of a private function, and that personal incomes would be distributed to individuals only for the purchase of consumers' goods and services and not for productive investment. But it would make possible the continuous distribution to the consumers of incomes sufficient to absorb the entire current production of consumable things.

Obviously so drastic a criticism of the existing economic order will not be readily accepted; for it amounts to a proposal for a radical change of the entire basis on which the economic system rests. We cannot pursue the matter further here; but it will be considered more fully in later sections of this book when we are dealing with the actual working of the very different economic system which already exists in Soviet Russia and with the "alternatives to Capitalism" advocated by Socialists, Co-operators, and other schools of advanced thought all over the world. In this section I have attempted only to lay bare the foundations on which the present system rests and the causes, as I understand them, of the "friction" in its working. It will at least be admitted that this "friction" has now assumed a character which calls for a searching examination of postulates once accepted by most people as universally valid, but nowadays more and more severely criticised as the disorders of the economic world threw the underlying defects of Capitalism into clearer and clearer relief.

CHAPTER V: PRICES AND THE PRICE LEVEL

1. Index Numbers
2. Recent Price Movements
3. Price Stabilisation

§ 1. INDEX NUMBERS

EVERY serious trade slump in the past has been accompanied by a sharp fall in prices ; and there is nothing exceptional in the mere fact that the prices of most things have fallen lower and lower during the past three years, as world trade and industry have plunged into deeper and deeper depression. The fall in prices since 1929 has indeed been exceptionally severe, and has acted with abnormal severity on the prices of certain classes of raw materials and foodstuffs. But this was only to be expected in view of the exceptional severity and extent of the depression. It is not, however, easy to say how far the slump in trade is to be regarded as a consequence of the falling prices, or the fall in prices as a consequence of the slump, or whether both are to be thought of as arising from some other independent cause. One school of thought regards the fall in prices as the direct cause of depression, but as itself the result mainly of monetary causes. Another school of thought lays stress on the effects of disproportionate production of different types of goods as leading to a fall in the prices of those things which have been "overproduced," and thus by a reaction to a fall in the prices of other goods and to a general condition of slump. Yet another school of thought appears to consider the fall in prices as good in itself, and to attribute the world's troubles mainly to the artificial keeping up of the prices of certain things, which is held to have led to lack of proportion

between world productivity and world demand for different classes of goods, and therefore to widespread disemployment of labour and other productive resources.

But let us for the moment leave the rival theories aside, and look at the actual facts concerning the movement of prices in recent years. Before we do this, we must have clearly in mind the distinction between different sorts of prices. Economists and statisticians make much use of the conception of a "general level of prices"; and certain series of price index numbers are commonly quoted as showing how this "general level" has changed in recent years. But in what sense save the vaguest can we speak at all of a "general level of prices"? And, even if we can, have we any means of measuring it with such accuracy as this use of index numbers seems to imply? It is, of course, obvious that the prices of the great majority of things are lower to-day—in most cases much lower—than they were in 1920 or even in 1929. But it is a far cry from this obvious generalisation to any representation of the change in the "general level of prices" by means of a precise index number.

Wholesale Prices. The index numbers which are commonly used as the basis of generalisations about the price level are those compiled by the various countries, in most cases officially, as showing the movement of wholesale prices for a typical selection of goods. The choice of types of goods for inclusion in the index is necessarily to some extent arbitrary. An attempt is of course made to cover as many as possible of the goods which are of vital importance in the national economy of the country concerned; but this can be done only to the extent to which satisfactory price data can be got. The availability of such data depends partly on the existence of an organised market for the goods in question, and partly on the degree in which the goods themselves are standardised, so that a representative price can be quoted for a whole range of commodities of standard quality.

Obviously these conditions are most likely to be satisfied

in the case of goods which are sold by quantity through recognised channels. Accordingly, the familiar index numbers of wholesale prices, in most cases, measure chiefly prices of raw foodstuffs and materials and of certain partly finished goods which are sold in bulk. Wheat and flour, meat and butter, coal and iron, raw cotton and wool, petrol and raw rubber—these are the types of goods for which standard prices can be fairly simply ascertained ; and the familiar indices of wholesale prices are mostly based on comparing and averaging prices for goods of these types. The wholesale price indices therefore measure mainly average prices of foodstuffs and materials, and hardly at all prices of manufactured goods when they leave the factory or are imported into the country. They are not really representative indices of all wholesale prices, but only of a selection which may or may not be typical.

Thus, when it is said that the level of British wholesale prices fell by 25% between the end of 1929 and the end of 1931, this cannot be taken as any evidence that British Manufacturers are on the average selling their goods for 25% less than before. It is better evidence that they are buying their raw materials for 25% less. But it is, of course, no evidence that any particular manufacturer or trade is doing this ; for the wholesale index is an average of a large number of prices which may have changed in very different degrees and even in opposite directions.

Weighting. Apart from the fact that the wholesale indices measure only some and not all wholesale prices, the making of a general average is not at all a simple matter even among the goods selected for inclusion ; for not all these goods are of the same importance. Cotton is far more important than silk and wheat than coffee ; and it would be clearly wrong to give changes in each of these four items the same " weight " in making up the general index. At least some rough system of " weighting " has therefore to be introduced in order to assign to each commodity approximately the right relative importance. This is usually

done, either by taking several different quotations for the more important types of goods—for example quotations for Canadian, Argentine and Australian as well as for British or American wheat—and then giving each quotation an equal " weight " in the total index ; or by assigning a definite " weight " to each class of goods in making up the index number—by saying, for example, that wheat shall count for ten and coffee only for one.

But this is not all ; for the same commodities will not have the same relative importance in the national economic systems of different countries, and accordingly the indices compiled by the different countries for the measurement of their own price levels will not be based on the same classes of goods or on the same " weights." Different national indices will therefore not be exactly comparable ; for a given change in the prices of, say, wheat and cotton will not have the same effect upon them all.

Index numbers of wholesale prices are, however, of considerable use provided that these limitations are borne constantly in mind, and that they are not mistaken for satisfactory measures of the changes in *all* prices, or of the prices charged by manufacturers for their goods. In fact the British wholesale index number, on account of Great Britain's high degree of dependence on imported foodstuffs and raw materials, is of great use as a rough indication of the movements of world prices in terms of sterling, and reflects world prices more accurately than the prices of British goods as a whole. The American index number, on the other hand, bears a closer relation to price conditions in the United States, because the Americans import and export less in relation to the volume of goods produced and consumed at home.

The Cost of Living. In addition to index numbers of wholesale prices, nearly all countries compile index numbers of retail prices or cost of living, and attempt by this means to measure changes in the working-class expenditure necessary to maintain a constant standard of life. But this too presents

considerable difficulties. The usual way of setting about it is to collect a large number of typical working-class " budgets " of weekly expenditure, and from these to compile a standard " budget " which is supposed to be representative of working-class expenditure as a whole. With this standard " budget " as a basis, regular data are then collected from shopkeepers showing the prices charged from time to time for the various articles ; and the index number is then so made up as to measure changes in the cost of purchasing the standard " budget " as a whole. The methods used in compiling these data vary from country to country ; but the general object is in all cases the same. The things, however, on which workmen spend their incomes differ greatly from one country to another and for workers at different standards of living : so that it is not easy to compare changes in the cost of living in different countries, or safe to assume that within a single country the cost of living has changed to the same extent for, say, a clerk and an unskilled labourer. The latter will usually spend a far higher proportion of his total income on food, and be more affected by changes in food prices than by changes in the prices of other goods. The various index numbers of retail prices and costs of living are therefore only very rough generalisations and approximations to truth ; but even so it is far better to have them than to have no means of measurement at all.

Other Index Numbers. In addition to the indices of wholesale and retail prices a few countries nowadays compile still rougher indices by which they attempt to measure changes in the prices of manufactured goods. Some countries also make up index numbers of agricultural prices as compared with the prices of industrial goods, or of the prices of imports as compared with those of exports. But no country has yet attempted to compile an index number purporting to represent the general average level of prices of all commodities whether at the raw, or the manufactured, or the retail stage.

Even if this could be done, it would not result in any

complete measurement of the "general level of prices." For many things besides currently produced commodities are being bought and sold, and have prices of their own. The prices of houses for renting, of gas and electricity, and even of certain types of insurance are sometimes included in cost-of-living index numbers; but apart from these there remain such important prices as those of the transport of passengers and goods, of stocks and shares in the Stock Markets, of land and industrial buildings rented or sold, of borrowed money (that is, the rates of interest), and above all of personal services (wages, salaries, fees, etc.). These and many other elements must be included in the conception of a "general price level." For some of them separate index numbers can be, and have been compiled in certain countries; but no one has yet been bold enough to group them all together with the wholesale and retail prices of commodities so as to make up a general index number for all the prices which are being paid within a particular community.

In the light of these facts, it is necessary to receive with a good deal of scepticism any assertion that in a country over a particular period the general level of prices has changed by so much per cent. This may be true, subject to the cautions mentioned above, of wholesale prices or of retail prices, or of some other particular kind of prices: but it is quite impossible to say that it is true of prices as a whole.

Nor can we conclude, even if we find what seems a remarkable resemblance between the changes over a period of years in the price index numbers of different countries, that there has been a corresponding change in the level of world prices as a whole. For the index numbers commonly used for such international comparisons—that is to say, the indices of wholesale prices—apply for the most part to those foodstuffs and raw materials which enter largely into world trade; and changes in their prices need not involve corresponding changes in the prices of other things. For these other prices are likely to be governed far less by world forces and far more by national or local causes.

Nevertheless, if we find a general tendency in most

countries for the index numbers of both wholesale and retail prices to move up or down, we may reasonably conclude that there exists some general force tending to raise or depress prices ; and it then becomes natural to look at world monetary conditions in order to see if they are likely to be responsible for what is happening. But, if we do this, we must beware of hasty conclusions ; for there are other factors besides monetary conditions which may cause the average levels of commodity prices to rise or fall in many countries at the same time. If, for example, technical improvements in industry and agriculture are proceeding at a great rate so as to reduce the real costs of production, or if world wages are rapidly falling, price levels are likely to move downwards on an international scale, even without any change in monetary conditions. Above all, we must always bear in mind that price index numbers are averages, so that a rise or fall of so much per cent may be the result either of comparatively small changes in the prices of most of the things included in the index, or of much larger changes in the prices of only a few. Any group of prices can be averaged ; but a good many averages really mean nothing, and every average needs careful handling if it is not to mislead. The average of one and ninety-nine is fifty ; but it is easy to see that very wrong conclusions could be drawn from the use of an average made up of two elements differing so widely.

§2. RECENT PRICE MOVEMENTS

WITH THESE cautions in mind, we can now proceed to look at a few from among the vast mass of data dealing with price movements in the past few years. Let us begin with only two series and two countries—with the movements of wholesale prices and the cost of living since the end of the War in Great Britain and the United States. Take first the indices of wholesale prices in the two countries expressed as percentages of their levels in 1913 and in 1920, and then set beside them the corresponding figures for the cost of living.

MOVEMENT OF PRICES IN GREAT BRITAIN AND THE UNITED STATES, 1913-1931

	WHOLESALE PRICES				COST OF LIVING			
	U.K. Board of Trade		U.S.A. Bureau of Labour		U.K. Ministry of Labour		U.S.A. Bureau of Labour	
1913 .	100	—	100	— (1914)	100	—	100	—
1920 .	307	100	221	100	255	100	205	100
1921 .	197	64	140	63	222	87	163	79
1922 .	159	52	139	63	181	71	156	76
1923 .	159	52	144	65	171	67	162	79
1924 .	166	54	141	64	171	67	162	79
1925 .	159	52	148	67	173	68	169	82
1926 .	148	48	143	65	170	67	166	81
1927 .	142	46	137	62	164	64	162	79
1928 .	140	46	140	63	165	65	161	78
1929 .	137	45	139	63	163	64	162	79
1930 .	120	39	124	56	157	62	152	74
1931 .	104	34	105	48	147	58	140	68

A glance at these figures at once reveals several important points.

(1) Wholesale prices more than doubled in the United States, and more than trebled in Great Britain, between 1913 and 1920, whereas the cost of living more than doubled in Great Britain and rose by nearly two-thirds in the United States.

(2) From the peak of 1920 prices fell sharply in both countries. Wholesale prices in Great Britain were almost halved between 1920 and 1922, while in the United States they fell by more than a third. The cost of living meanwhile fell by nearly a third in Great Britain and nearly a quarter in the United States.

(3) The rise in prices up to 1920 and the fall from 1920 to 1922 were both much larger in Great Britain than in the United States; but in 1922 British prices were still much further above the pre-war level than American prices.

(4) From 1922 to 1925 there was, on the whole, no further fall in British wholesale prices; and a temporary rise occurred in 1924. Over the same period American wholesale prices rose slightly. There was a small fall in the British and a small rise in the American cost of living.

(5) From 1925 to 1929 British wholesale prices fell steadily, while American wholesale prices, after a temporary rise in 1925, declined only a very little from the level of 1922-1925. The cost of living fell in both countries until 1927, and then remained practically stationary until 1929.

(6) From 1929 to 1931 both wholesale and retail prices fell sharply in both countries. But whereas American prices were still falling up to the end of 1931, British prices turned slightly upwards after the suspension of the gold standard in September of that year. Nevertheless the average level of British wholesale

prices in 1931 was barely one-third of what it had been in 1920.

(7) Between 1920 and 1931 wholesale prices fell by two-thirds in the United Kingdom and by over 50 per cent in the United States; but the cost of living fell only by 42 per cent and 32 per cent in the two countries.

What explanation can be offered of these vast and disturbing price movements? It will be seen that they do not at all completely correspond for the two countries. Both Great Britain and the United States underwent the two catastrophic price falls of 1920 to 1921 and 1929 to 1932, but in the intervening period their price history differs.

Causes of Price Changes in Great Britain. Between 1920 and 1921—in Great Britain between 1920 and 1922—both countries experienced a sensational collapse of the post-war boom. The fall in prices was greater in Great Britain, as the previous rise above the pre-war level had been greater, than in the United States. For Great Britain had gone off the gold standard, whereas the United States remained upon it. The value of British money was depreciated in terms of gold; and consequently more British than American money had to be given in order to buy goods in the world market. By 1922 this difference had been much narrowed, but it had by no means completely disappeared. The United States, having liquidated her post-war boom and being upon the gold standard, had no inducement after 1921 to force prices down by artificial means; but Great Britain was still off the gold standard, and her financial authorities were eager to return to it. No decisive step was, however, taken until 1925, when the temporary upward movement of prices in the United States seemed to offer an opportunity for a return to pre-war parity between the pound and the dollar. But the rise in American prices was of short duration; and the restoration of the gold standard at pre-war parity therefore involved drastic measures designed to force British prices down. The British Government

and the Bank of England were, however, determined that the pound must " look the dollar in the face " ; and the gold standard was actually restored in 1925. In 1928, wholesale prices in both countries stood at 40 per cent above the pre-war level ; and some people maintain that this proved that the restoration of the old parity had been a success. But in fact it proved nothing of the sort ; for a high Bank rate, and a drastic restriction of credit had been found to be necessary in order to keep the pound at, or near, the old parity with the dollar. Why did this happen, despite the apparent harmony between the wholesale prices of the two countries ?

It happened, first and foremost, because the wholesale indices did not really measure the total price levels of Great Britain and the United States. The prices of the manufactured goods which are Great Britain's principal exports remained in fact a good deal more above the pre-war level than the wholesale price index. This was true of the United States as well, though not in the same degree, owing to a very sharp fall in the prices of metal goods ; but the United States did not depend to the same extent as Great Britain on the export of manufactures. In returning to the gold standard at the old parity Great Britain over-priced her principal exports in the markets of the world, and so caused unemployment and depression in her export trades. This situation made continued credit restriction and high interest rates necessary in order to attract foreign money to London and so keep the sterling exchanges stable, and also in order to force down still further British internal prices, and above all the price of labour. Great Britain's difficulties moreover were accentuated by the American business boom, which led to a migration of short-term capital to the United States, and so to an additional strain on the sterling exchange, and enforced a further restriction of credit.

Prices in the United States. While Great Britain had thus been taking artificial measures in order to force down prices, the United States, securely on the gold standard and

under no fear for her exchanges, had been pursuing the policy of stabilising prices by enlarging the supply of credit as industrial production increased. Productivity in the United States had been rising rapidly, mainly through the increasing mechanisation of both industry and agriculture. Costs of production thus tended to fall as the same quantity of goods was produced with less labour, and the effect was the greater because wage-rates rose relatively little. Normally, this would have caused prices to fall ; but the banks steadily counteracted this tendency by increasing the supply of money. This policy did not, of course, prevent changes in the prices of particular goods ; but it did keep up the average level. As wages rose but slowly and less labour was employed, profits were greatly swollen ; and there was a rush to invest capital in industry, and still more to buy up the common stocks of existing industries at rapidly rising prices. A great business boom thus occurred in the United States ; but it was not accompanied by the usual rise in commodity prices because costs of production were falling. A stationary price level thus afforded an amply sufficient incentive to business enterprise.

American financial policy could not, however, stabilise the prices of those goods which had to be sold largely under conditions of world competition. Long before the world slump began, American farmers were finding, as we have seen, that the relative values of their products were declining. It has been estimated that just before the crisis of 1929 they were selling on the average at 40 per cent above pre-war prices and having to buy at 55 per cent above. And, as we saw in an earlier section, this fall in the consuming power of the farmers joined with the failure of wages to rise in proportion to productivity in such a way as to bring about a shortage of demand for consumers' goods.

The policy of stabilising the wholesale price level in the United States thus broke down because of the failure of consuming power ; and the breakdown was accentuated by the diversion of the new money created by the banks into speculation on the stock markets and in real estate ; for in

the long run the value of land and invested capital was bound to depend on the maintenance of a satisfactory volume of consumers' demand. Thus Great Britain, where money was kept artificially scarce, in order to force prices down, suffered from continuous depression between 1926 and 1929, whereas the United States, where money was made artificially plentiful, underwent an immense boom followed by a sensational collapse.

We have seen that from the crisis of 1929 to the end of 1931 prices in both Great Britain and the United States fell sharply, though not so sharply as in the great post-war deflation of 1921. But the collapse of prices after 1929 cannot be attributed mainly to monetary policy in either Great Britain or in the United States; for in both countries the banks were now helpless in face of forces far too strong for them to control.

American bankers could not have kept prices stable however much they had tried, for the failure of consumers' demand and the general realisation that stocks and shares had been grossly over-valued left no outlet for additional supplies of money. Nor was it possible for the Bank of England to force British prices down any faster than they were falling in the world as a whole—or indeed as fast. From 1929 to the end of 1931, if banks were decreasing the supply of money, this was much more because of the fall in demand for it than from any deliberate desire to deflate.

Price Movements in Other Countries. Let us turn now from the movement of prices in Great Britain and the United States to the corresponding movements in some of the other leading countries. The position on the continent of Europe is complicated by the vast inflation which the money of some countries underwent either during or shortly after the War. Germany is the extreme example of this. In 1919 German wholesale prices were four times as high as before the War, in 1920 fifteen times as high, and in 1922 three hundred and forty times as high; while in the final inflation of 1923 the German currency practically lost all value and prices rose

many million-fold. Thereafter in 1924 a new currency was introduced and kept stable in terms of gold ; and prices in this new money fell at once to only 37 per cent above the pre-war level.

The French inflation was a very different matter from the German ; but even in France prices were in 1920 five times as high as in 1913 and in 1926 seven times as high. With the franc finally stabilised at one-fifth of its pre-war value wholesale prices were, between 1927 and 1929, about six times as great as before the war ; while in Italy they had settled down before the world slump at about five times the pre-war level. Scandinavian prices also rose to about three and four times the pre-war level in 1918, and Dutch prices to nearly three times. But in these cases there was speedily a large drop ; and this group of countries followed the British policy of a return to the gold standard at the pre-war par of exchange.

We have thus to take into account two groups of countries —those which remained upon, or returned to, the gold standard at the old parity, and those which either lowered the gold value of their currency by devaluation, or issued new currencies based on gold in place of the old ones.

The figures set out on the following page illustrate the movement of wholesale prices since 1920 in the leading countries. It will be seen that in 1920 British wholesale prices had risen a good deal more than the average—only Sweden among the countries in the first group showing a bigger rise. But by 1922 British and world wholesale prices were again in equilibrium ; and British prices remained at, or near, the general average until after the return to the gold standard in 1925. From 1925 onwards, however, the British price level tended to fall below the average.

The question, of course, is whether this relative fall of British prices was, or was not, due to the return to the gold standard at too high a valuation of the pound sterling. It must be remembered that the British index of wholesale prices measures the price level, not of British manufactures but principally of foodstuffs and materials which are largely

WORLD WHOLESALE PRICES, 1920-1931. (1913=100)

	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931
A. Countries which remained upon, or returned to, the gold standard without devaluation.												
United Kingdom	307	197	159	159	166	159	148	142	140	137	120	104
United States	221	140	139	144	141	148	143	137	140	138	124	105
Switzerland	—	191	168	181	175	162	145	142	145	141	127	110
Holland	292	182	160	151	156	155	145	148	149	142	117	97
Sweden	359	222	173	163	162	161	149	146	148	140	122	111
Norway	—	—	—	232	268	253	198	167	157	149	137	122
Spain	221	190	176	172	183	188	181	172	167	171	172	174
Japan	259	200	196	199	207	202	179	170	171	166	137	116
Argentine	180	143	130	135	145	147	132	130	130	127	122	117
Canada	244	172	152	153	155	160	156	153	151	149	135	113
Australia	228	175	162	179	173	170	168	167	165	166	147	131
South Africa	223	160	128	127	129	128	123	124	120	116	103	100
B. Countries which devaluated their currencies, or issued new ones.												
Germany	1486	1911	34,182	16,620,000 000,000	137	142	134	138	140	137	125	111
France (francs)	509	345	327	419	489	550	703	617	620	610	532	455
(gold)	—	—	—	—	—	—	—	125	126	124	109	92
Italy (lire)	—	517	529	536	554	646	654	527	491	481	411	342
(gold)	—	—	—	—	—	—	—	—	134	131	112	92
Belgium (francs)	—	366	367	497	573	559	744	847	843	851	744	626
(gold)	—	—	—	—	—	—	—	123	122	124	108	90
C. Rough calculation of average level of world prices (medium of 15 countries).												
	228	182	160	159	162	160	148	142	145	140	124	110

imported. The indices of other countries also measure mainly prices of raw goods, though not in all cases to the same extent. The German index, for example, includes a much larger element of manufactured goods than the British. The relative fall in the British index may therefore be due largely to the heavy drop in the prices of imported foodstuffs and materials rather than to any monetary cause. But the deflation which followed the return to the gold standard was certainly a factor in bringing about the relative decline in the British wholesale index.

It is clear that the prices of British exports did not fall to the same extent as either import prices or wholesale prices as a whole. They were, in fact, even in 1931, still on the average about 40 per cent above the pre-war level, whereas the average prices of imports were actually five per cent below the pre-war level. This relative rise in the prices of manufactured goods was even before the slump to some extent common to the whole world ; and it has been everywhere accentuated since the slump set in. But the discrepancy has been greater in Great Britain than over the world as a whole, because the high external valuation put upon the pound set the British manufacturer an exceptionally difficult task in cutting down his costs.

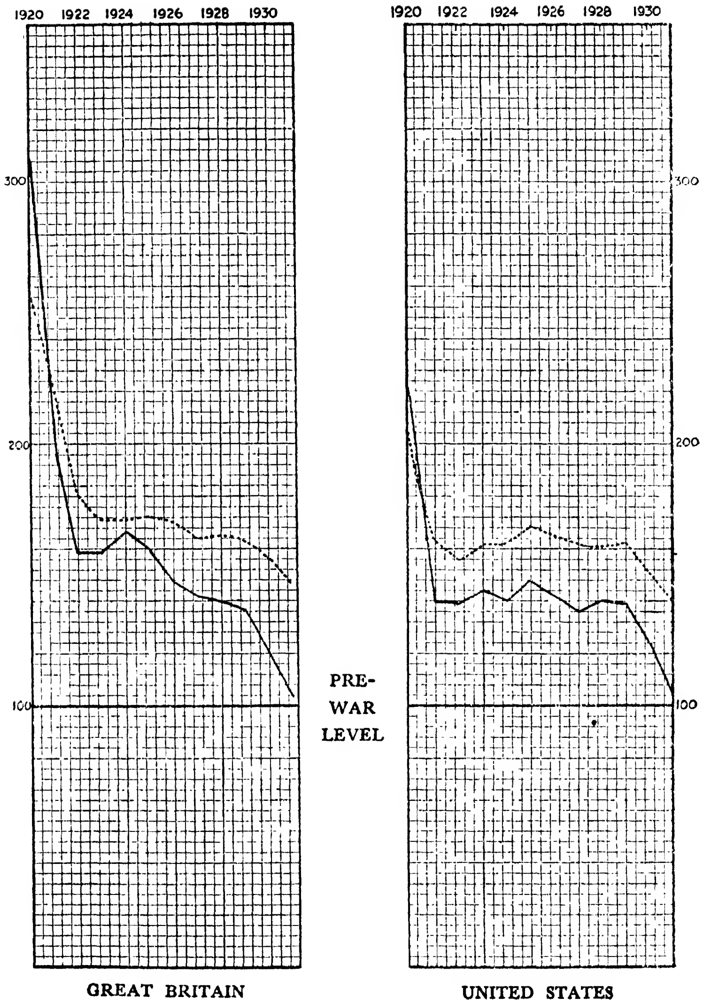
Wholesale and Retail Prices Compared. We may now turn from wholesale to retail prices, or rather to the various national indices measuring the changes in the cost of living. We have seen that the cost of living rose a good deal less in the United States than in Great Britain during and after the war, but after 1921 the two indices came closer together, and from 1925 there was not much difference in the rate of increase over pre-war costs in the two countries. American retail prices, however, fell faster than British after 1929 in consequence of the more catastrophic effects of the slump in the United States.

It is usual, when a slump sets in, for wholesale prices to fall further and faster than the cost of living, just as they rise further and faster in times of boom. This happens because

changes in demand react very greatly and rapidly upon the prices of foodstuffs and raw materials, but far less rapidly on those of finished goods. For it is, generally speaking, much easier to adapt the supply of finished goods quickly to a changing level of demand. Foodstuffs and many raw materials have to be produced a long time before they are consumed and take a long time to produce, so that, whereas most manufacturers reduce their buying of them if the demand for manufactures falls off, it takes the primary producers much longer to adjust their supply. Moreover, the manufacturers are often able to combine in order to restrict supply and keep up prices, whereas most of the leading foodstuffs and materials are produced competitively over too wide an area for this to be easily done. It is true that during the present slump the producers of certain types of foodstuffs and raw materials, such as coffee and copper, have combined to keep up prices; but they have been able to do so only at the cost of holding large stocks off the market. Either the mere presence of these stocks has demoralised the market and so forced prices down as in the case of wheat or, as in that of copper, it has finally become impossible not to unload the stocks, and prices have in the end crashed even more sensationally than if they had been allowed to adjust themselves freely in the first instance.

It is, then, not surprising that between 1920 and 1922 the cost of living fell in all countries a good deal less than the wholesale price level, or that in most countries this was also the case between 1929 and 1932. But it does call for comment that in the intervening years, whereas in America wholesale and retail prices followed much the same course in Great Britain wholesale prices continued to fall a good deal faster than retail prices, so that the gap between the two grew almost continuously wider, as the diagram on the opposite page plainly shows.

The Return to Gold. It is hardly open to doubt that this widening gap was one of the results of Great Britain's return to the gold standard at pre-war parity. For this



Wholesale Prices and Cost of Living in Great Britain and the United States, 1920–1931

——— Wholesale Prices

.... Cost of Living

writing up of the external value of British currency enabled Great Britain to buy goods more cheaply in world markets without causing an equivalent fall in British costs of production. Not only did the British Trade Unions offer strong resistance to wage reductions : rates of interest were also kept at a high level owing to the desire to attract foreign capital to London in order to maintain the exchanges at the artificially high rate involved by the return to pre-war parity. The prices of British exports therefore remained high, with the consequence that British exporters lost trade in the world market ; and the British cost of living also remained high in relation to the falling level of world prices.

It is true that in some other countries also the margins between wholesale and retail prices were growing wider. But, in some of these cases as well, the cause is to be found in the deflation which accompanied the return to gold. For, as the events of 1931 plainly revealed, Great Britain was not the only country which had over-valued her currency in terms of gold. In France, on the other hand, the cost of living measured in gold remained low in relation both to the pre-war cost of living and to the current level of wholesale prices ; for France's method of returning to the gold standard by devaluation instead of deflation had precisely the opposite effects to those which were experienced in Great Britain.

The accompanying table sets out the official figures of changes in the cost of living since 1920 in those of the leading countries for which figures are available. I have again divided the countries into two groups on the same principle as in the table showing the movement of wholesale prices.

Effects of Suspending The Gold Standard. It remains to consider the effects on prices of the renewed departure from the gold standard by Great Britain and a number of other countries in 1931. British politicians have pointed with pride to the fact that up to the middle of 1932 there had been no considerable rise in either wholesale or

THE COST OF LIVING, 1920–1931

Pre-war = 100.

	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930	1931
United Kingdom	255	222	181	171	171	173	170	164	165	163	157	147
United States	205	163	156	162	162	169	166	162	161	162	152	140
Switzerland	224	200	164	164	169	168	162	160	161	161	158	150
Holland	219	208	187	174	173	179	171	167	170	169	162	151
Sweden	270	236	190	174	171	176	172	169	173	169	165	159
Norway	307	277	231	218	239	243	206	186	173	166	161	153
Denmark	262	237	199	204	214	219	184	176	176	173	164	156
India (rupees)	190	177	165	153	157	157	157	—	—	—	—	—
(gold)	—	—	—	—	—	—	—	176	165	167	154	124
Peru	202	191	183	173	180	192	193	187	174	170	163	152
Canada	188	165	152	152	148	150	152	149	150	151	151	137
Australia	—	—	—	145	143	144	146	145	146	149	141	128
South Africa	179	162	135	131	133	133	131	131	131	131	128	123
Germany	—	—	—	—	126	143	142	150	153	154	147	136
France (francs)	341	307	302	334	366	390	485	525	519	556	572	571
(gold)	—	—	—	—	—	—	—	—	105	113	118	116
Italy (lire)	441	494	488	487	512	598	649	548	526	542	531	483
(gold)	—	—	—	—	—	—	—	—	143	148	145	132
Poland	—	—	—	—	—	—	—	115	123	123	119	99
Median of available series	219	200	183	168	169	169	166	164	161	162	157	136

retail prices in Great Britain, despite the heavy fall in the gold value of the pound. What is apt to be overlooked is that, after Great Britain went off gold, prices in the gold standard countries continued to fall, so that British wholesale prices would also have fallen if British currency had remained on a gold basis. The position is illustrated by the following figures. Between September 1931 and the end of the year the gold value of the pound sterling measured by the dollar exchange fell by about 30%. Over the same period, according to the *Economist*, sterling prices of a representative group of primary commodities rose by about 17%. But in the meantime the gold prices of these same commodities in the world market fell by over 5½%. The real rise in sterling prices as compared with gold was thus nearly a quarter. Even so, sterling prices of these commodities rose less than the gold value of the pound fell. This was partly due to the existence of accumulated stocks, but it happened also because Great Britain was able to draw a greater part of her supplies from countries which were also off the gold standard. Meanwhile the cost of living in Great Britain rose only to a very small extent—by hardly more than the normal seasonal rise of previous years. But in this case too the fall in world prices has to be taken into account. If Great Britain had remained on the gold standard, both wholesale and retail prices would have fallen sharply since September 1931.

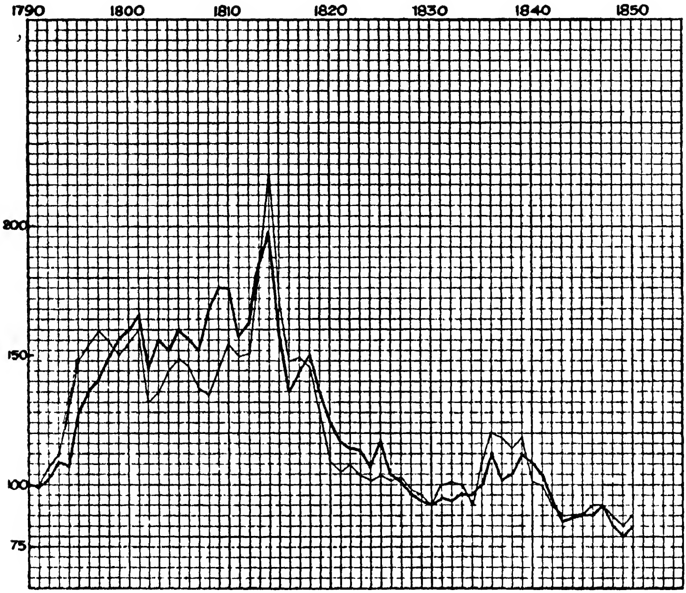
§3. PRICE STABILISATION

So far we have been considering prices in general. But, as we have seen, the index numbers measuring general prices are made up out of the particular prices of many different kinds of goods; and for most purposes the movements of these particular prices are of more importance than estimates of changes in the general level. For changes in the relative prices of different goods can be quite as upsetting to the economic system as general upward or downward

movements ; and during the past few years there have been the most extraordinary and devastating changes in the prices of certain particular kinds of goods.

The most startling case of all is that of rubber. The price of plantation sheet rubber in the British market fell from nearly 4*s.* per pound to 8*d.* at the end of 1927 and 2½*d.* in August 1931—or by 95%. In this instance the high price of 1925 was the result of artificial restriction of supply in face of rapidly growing demand ; while the later prices show the results of over-production following upon the breakdown of the restriction scheme—and indeed partly caused by it through the expansion of output in areas which the scheme did not cover, such as the Dutch East Indies. Rubber prices in 1931 involved for the majority of producers a large dead loss, and even so there were big surplus stocks awaiting disposal. There is no other case quite comparable with this, but there are plenty in which even after a huge fall in prices between 1920 and 1922 prices were again halved or more between 1924 and 1931. The British market prices shown in the table on page 214 will serve to illustrate the position as it was at the end of 1924 and of 1929 and in August 1931 on the eve of Great Britain's suspension of the gold standard. It will be seen that between 1924 and 1931 the prices of Canadian wheat, maize, cotton, wool and lead had all fallen by two-thirds or more, those of English wheat, tin, copper, coffee and butter by almost one half or more, while New Zealand mutton had fallen by a third, and pig-iron, coal, timber, beef and cheese by a quarter or more. Naturally it was impossible for the producers of most of these goods to adjust their costs to price reduction on such a scale.

Costs of production did, however, fall very greatly. This was partly the result of lower wages ; for there was in most countries a scramble to reduce wage rates in face of falling prices. It was also the result of improved methods of production—that is, of a fall in real as well as money costs. Such a fall occurred in agriculture as well as in the extractive and manufacturing industries ; for the growth of



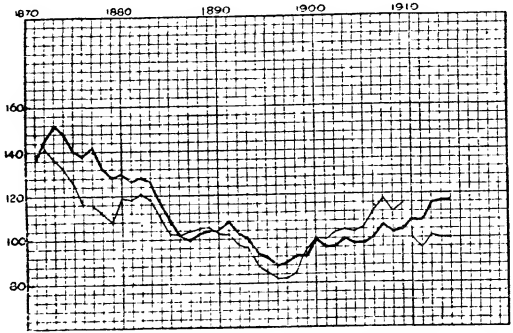
THE INSTABILITY OF PRICES. I.

Wholesale Prices in Great Britain and the United States during and after the Napoleonic Wars

1790–1791 = 100

——— Great Britain (Silberling's Index)

- - - U.S.A. (Department of Agriculture Index)



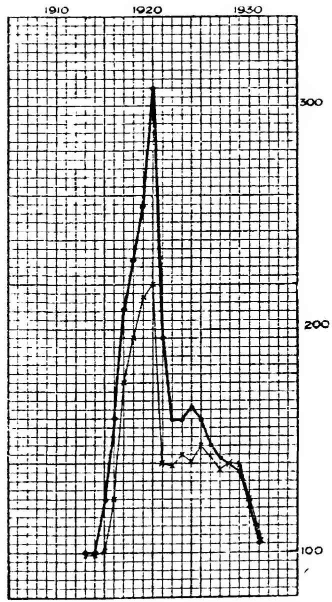
THE INSTABILITY OF PRICES. II.

Wholesale Prices in Great Britain and the United States from 1871 to 1914
(1900 = 100)

——— Great Britain (Board of Trade)

——— U.S.A. (Bureau of Labour)

(New Index from 1910 [1913 = 100])



THE INSTABILITY OF PRICES. III.

Wholesale Prices in Great Britain and the United States during and after the War. (1913 = 100)

mechanisation in industry had its counterpart over a large part of the world in improved methods of cultivation and more scientific selection and raising of crops and stock. The world had indeed up to the beginning of the depression been increasing its actual output of foodstuffs and raw materials very rapidly ; and a substantial part of the increase was due to better methods of production.

The extreme instability of all prices in recent years has led in all countries to a growing demand for price stabilisation. In face of swiftly falling prices producers have argued that, if only prices could be kept stable, depression would disappear and industry be able to progress without fear of further setbacks ; for growing productivity would, with prices stable, hold out the prospect of both higher profits and higher wages, and thus benefit employers and workmen alike.

Should Prices Be Stabilised ? The matter, however, is far less simple than it sounds ; for what prices are we to set out to stabilise ? Are we to peg the general level of wholesale prices, or the cost of living, or the wholesale or retail prices of particular goods and services ? Is price stabilisation to be national or international ? And finally, when we have made up our minds about the sort of stabilisation we want, how are we to bring it about ?

There have been a good many attempts of late years by particular groups of employers to stabilise the prices of the goods they have to sell ; but obviously, as methods of production and currents of demand change, the costs of producing goods of different kinds do not all change in the same proportion. If the price of each kind of goods were stabilised some trades would soon be selling at much above cost price, and others at a far smaller margin. Some trades would reap a large harvest of surplus profits ; and the expansion of demand for goods whose costs of production fell greatly would be checked in a most undesirable way. It may be a good thing to prevent short-term fluctuations in the prices of particular goods ; but it would be clearly

absurd to fix the price of each kind of goods at a particular level irrespective of subsequent changes in the cost of producing them. The permanent stabilisation of particular prices can therefore be definitely ruled out.

Ought we then to try to stabilise the general level of prices ? This is none too easy either ; for it has been pointed out already that no data exist for measuring what the general level of prices is. Let us however assume for the moment that the object is to stabilise the level of wholesale prices in some form. This level is of course made up as an average of a large number of particular prices. If this average is to be stabilised, whenever the price of one thing falls the prices of other things will need to be raised so as to compensate for the fall. And if in most trades real costs are tending to fall because of increasing efficiency, this means that the marginal profit is bound to rise unless the whole improvement in productivity is absorbed in the form of higher wages. In an economic system in which productivity is advancing the stabilisation of prices involves the distribution of the entire benefit of growing efficiency in the form of increased incomes to the producers.

Why not ? it will be asked. Why not indeed, if the thing can be so contrived ? For most people prefer rising incomes to falling prices ; and the former are far more likely to stimulate an increase in production. The difficulty, however, is that productivity does not advance at a uniform rate in different countries any more than in different industries. If then the general level of prices were stabilised even by international agreement, while particular prices were allowed to change, the most rapidly advancing industries in the most rapidly advancing countries would be able to undersell their competitors in world markets to an ever-increasing extent. Again it will be asked, Why not ? It is true that, if general prices are to be kept stable, the fall in the prices of these cheaply produced goods will have to be balanced by an increase in the prices of other goods ; but as long as incomes are increased in proportion this seems to cause no difficulty.

This is true, however, only on the assumption that the general price level can be stabilised on a *world basis*. But can this possibly be done? Except for a quite narrow group of standardised primary commodities no such thing as a world price can be held to exist. Certainly there is no such thing as a world price level in any complete sense. For the prices of most things are largely influenced by national and even local causes. In the first place, each country has its own separate currency system, through which it controls the amount of money issued and therewith its national price level, as far as this depends on monetary causes. It is true that, as far as different countries are on a common monetary standard such as gold, the exchangeability of their currencies for gold at fixed rates tends to keep their price levels in some sort of equilibrium; but it certainly does not cause the national price levels of all gold countries to be the same, or even to preserve a constant relationship. In order to stabilise world prices the world would need a common currency managed by a world banking system to which all countries would have to give up the power of regulating monetary conditions. Possibly some day the world may be ready for such a system; but there is assuredly no chance of its acceptance to-day.

Is There a World Price Level? We should have moreover, to make up our minds definitely what we mean by a world price level. Different commodities are of very different importance in different countries. But, as we have seen, any general index of prices involves "weighting" of the particular commodities included in the index in accordance with their relative importance. How can this possibly be done for the world as a whole? A "weighting" correct for the world as a whole would inevitably be wrong for every particular country.

Moreover the price level in each country is caused not only by monetary policy, but also by taxation and especially by tariffs and other forms of protection. If some countries raise their tariffs and so cause their prices to rise, is this to

involve a compensating fall in prices in other countries? It must do so if the world price level is to be stabilised; but certainly other countries will not endure this. They are more likely to raise their own tariffs and therewith their own prices by way of retaliation. The idea of a world price level therefore could hardly be entertained except in a world which had definitely abandoned tariff protection.

Indeed the whole notion of a completely stabilised level of general world prices is based on an illusion, although a good deal could be done to make world prices less unstable than they are to-day. What then of the alternative of stabilising general prices on a national basis? Should each country aim at stabilising its own internal level of prices, while leaving this level and accordingly its rates of exchange to fluctuate in relation to those of other countries?

National Stabilisation. This is, within limits, a more practicable policy; but it is obviously incompatible with the existence of the gold standard in its present form, or indeed of any international monetary standard designed to fix permanently the relative values of different national currencies. This would be the case even if all countries adopted simultaneously a policy of national price stabilisation; and it would be far more obviously the case if some countries attempted to stabilise their internal prices while others did not. The national currencies of the different countries might indeed be kept stable by currency management over short periods—for long enough to meet the needs of traders and short-term investors and depositors. But there would have to be means of altering the relative values of national currencies in accordance with long-term changes. This might possibly be done under a revised form of the gold standard, under which each country would be free to vary from time to time the gold equivalent of its currency; or it could be done by management of the exchanges without any metallic standard at all. The point cannot be pursued further here. It will be dealt with more fully in the next chapter.

Price Stabilisation in the United States. If a country is prepared to let its exchanges fluctuate, it can attempt to stabilise within limits its national level of prices. The United States in effect did this with some success in the years immediately before the world slump ; but even this policy is not easy to work. For, as we have seen, it is no simple matter to define what the general level of prices is, even for commodities alone. But money is used to buy not only commodities but also personal services of every kind, and not only the currently produced supply of currently consumed goods and services, but also land and property of every sort including stocks and shares. The only way open to a country which sets out to fix the general level of prices is that of adjusting the supply of money, including credit issued by the banks as well as currency. But currency and credit can be used to buy anything that is for sale ; and the creation of a given amount of money affords no guarantee that a fixed proportion of it will be used for buying commodities rather than, say, stocks and shares. This was the fundamental difficulty which the United States encountered in its attempt to stabilise commodity prices. As costs of production were falling, stable prices meant higher profits ; for the fall in real costs was not passed on to the workers in higher wages. As the output of goods produced at lower costs increased, more and more money had to be put into circulation in order to stop prices from falling ; but a large part of this additional money was used to buy not currently produced goods and services, but stocks and shares, land, and other forms of property. The more money was diverted in this way to capital transactions, the more new money had to be pressed into circulation in order to keep up commodity prices. The instalment purchase system was one means of doing this ; and it helped for some time to keep the American boom in being, by giving an artificial stimulus in the demand for goods. But in face of the growing mechanisation of industry, which reduced the demand for labour even though production continued to increase, it became progressively harder to check the flow of money into

stock speculation, and to keep up the demand for goods. More and more of the new money was used to buy property rather than current goods and services ; and this went on until people at length realised that the value of property depended on the maintenance of demand for the goods it could be used to produce. As soon as this was understood the stock markets crashed, and the American banking system found itself powerless to maintain the price level in face of a rapid contraction in the demand for money. For it could not go on putting more money into circulation unless people were prepared to borrow this money ; and after the stock markets collapsed they neither would nor could.

National price stabilisation thus foundered in America on the rock of stock market speculation, and the limitations of the policy of stabilising the price level merely by adjusting the total supply of money were plainly illustrated. It is not suggested that stock speculation was the ultimate cause of the American collapse ; for speculation itself was an effect of a more deeply rooted cause. If, as American productivity increased, wages and other small incomes had risen fast enough in the aggregate to absorb the growing supply of goods, there would have been far less speculation on the stock markets and in real estate, even though the real value of stocks and shares and of property would have been greater. But under the existing economic system this could not well have happened ; for the greatest advances in productivity were made in those industries which were most successful in displacing labour by machinery. Even if individual earnings had risen very fast—which they did not—the total wage bill would have tended to fall owing to the displacement of labour ; and this would still have reacted on the total demand for consumers' goods. Moreover, higher wages in the industries which increased their productivity most would not have led to a general rise in wages in other industries where productivity was advancing less, and would therefore not have brought about that general diffusion of increased purchasing power which was really needed. This would have come about only if

prices had been allowed to fall in the more productive industries without compensating rises in the prices of other goods. In other words, an adequate distribution of purchasing power over the whole body of consumers was inconsistent under the existing economic system with the stabilisation of the price level.

Doubtless this difficulty would not have arisen if America had been a Socialist community such as Russia ; for in such a community the State could have balanced its policy of general price stabilisation by paying out enough in wages to maintain the right volume of demand, without any regard to the relation between wages paid and costs of production in *any particular industry*. But the United States is a capitalist country, in which each employer has to do his best to get for himself and his stock-holders a surplus over his costs. Wages therefore could not be raised in industries in which real costs of production were falling less than the average without leading to increased unemployment. In fact, over industry as a whole wage rates rose very slowly ; and yet owing to mechanisation in the advancing industries the total volume of employment did not increase.

The experience of America therefore suggests a doubt whether the policy of general price stabilisation, even on a national basis, is really practicable for a capitalist country ; for it seems that such a country cannot ensure the necessary expansion of consumers' demand solely by raising wages, but must allow prices to fall if it is to find an outlet for an increasing product. This does not mean that it ought not to raise wages. Certainly it should ; but a fall in prices will be needed as well, if the product of rising efficiency is to be successfully absorbed.

Reducing Price Fluctuations. Prices could, however, in most countries advantageously be made much less unstable than they are to-day, for changes in particular prices and in the price level arise from two distinct groups of causes—even apart from the effects of monopoly and of disturbances due to external factors such as war, and

apart also from temporary dislocations arising from changes in the direction of consumers' demand. Prices may rise or fall either because the conditions of production or because the monetary conditions change. Changes in the conditions of production operate only on the prices of particular goods, though of course a single change may affect more than one industry. Changes in monetary conditions, on the other hand, affect the prices of all goods, although not to an equal extent in all cases.

It may be highly desirable to eliminate as far as possible all price changes which are due to changes in monetary conditions, while leaving prices free to adjust themselves to changes in the conditions of production. This does not mean that the supply of money should be kept invariable ; for to do this would involve forcing prices down artificially as the supply of goods increased. But neither does it mean that the supply of money should be increased in proportion to the increase in the supply of goods ; for in view of falling real costs of production that would mean an artificial raising of prices which would lead to a bad and disastrous distribution of income in the community. The right course, if it can be so contrived, is to let prices fall as productivity advances, but possibly to let them fall a little less, but not much less, than enough to correspond to the rise in productivity. For under Capitalism a small stimulus to production in the form of rising prices may be necessary, whereas a large dose of this stimulant is bound to lead to disaster.

But if this is the end to be aimed at, how is it to be achieved ? Clearly it cannot be done by making the supply of money depend automatically on the movements of any index number either of prices or of production. For indices of prices reflect the combined results of *all* causes acting on prices ; and indices of production tell us nothing about costs. In fact, a wise monetary policy designed to secure a right degree of stability and flexibility in the price system cannot be *automatic*. It must depend on judgement, on conscious *management* based on an attempt to disentangle

the distinct causes of price fluctuation. The right degree of price stability can be brought about only by applying common sense rather than rule of thumb to the control of monetary policy.

Moreover, apart from the question of the general price level, *relative* prices are of crucial importance ; for their fluctuations have been at the back of some of the most serious troubles of recent years. As we saw, prices of raw materials and foodstuffs have fallen far more heavily than prices of manufactured goods. The effect has been to depress the buying power of those countries which depend largely on the export of raw produce ; and the decrease in their demand for manufactured goods has caused widespread unemployment in the industrial countries. Moreover, in countries such as the United States, which are large producers of both types of goods, the depression of the farmers' buying power has reacted on urban industry in precisely the same way as the collapse of, say, the Australian market reacted on Great Britain.

Industrial and Farm Prices. It is indeed easier to illustrate the situation by using the American example than by taking a case in which the resulting disturbance has been spread over a number of countries. It has been estimated that the purchasing power over goods in general of a given quantity of American farm products fell by 25% between 1913 and the winter of 1931, and that of a given quantity of industrial raw materials by 30%, whereas a given quantity of urban manufactures had risen in purchasing value by 9% over the same period. The average prices received by farmers for their produce had fallen by a third ; while the prices they had to pay for their supplies had risen by a quarter.

The situation is practically the same between a farmer, in say, Australia or Hungary and a manufacturer in Great Britain or France—or was so until one country after another was driven to suspend the gold standard. The following figures illustrate, for those countries for which particulars are

RELATIVE PRICE CHANGES OF RAW AND FINISHED GOODS 1913-1930

(1913=100)

Country	Raw Goods	Finished Goods
Germany	110*	143
Italy	336	415
Canada	106	126†

* Excluding foodstuffs. † Including semi-manufactures.

THE FALL IN COMMODITY PRICES, 1924-1931

	1924 end	1929 end	1931 August		Percentage fall 1924-1931
A. HEAVY FALLS					
Cotton (American middling)	13·6	9·4	3·9	pence per lb.	71
,, (Egyptian)	29·8	14·1	5·9	pence per lb.	80
Wool (English)	37·0	23·0	12·5	pence per lb.	66
Lead (English Pig)	45·0	23·2	13·2	£ per ton	71
Tin (Standard)	267	178	108 (July)	£ per ton	60
Copper (Standard)	67	68	33	£ per ton	51
Rubber (Plantation Sheet)	20 (1925, 46)	8	2.25	pence per lb.	89
Wheat (N. Manitoba)	73/–	55/6	23/3	shillings per quarter	68
,, (British average)	12/2	9/6	6/3	shillings per cwt.	49
Maize (La Plata)	48/–	31/–	15/9	shillings per quarter	67
Coffee (Costa Rica)	187/6	165/–	95/–	shillings per cwt.	49
Butter (Danish)	244/6	180/–	112/– (July)	shillings per cwt.	54
B. COMPARATIVELY LIGHT FALLS					
Pig Iron (Cleveland No. 3)	81.5	72.5	58.5	shillings per ton	28
Iron Bars (Middlesbrough)	12.0	10.75	10.0	£ per ton	17
Coal (Welsh Best Steam)	27/–	20/1.5	20/–	shillings per ton	26
Coal (Sheffield Best House)	27/–	21/–	19/6	shillings per ton	28
Timber (Swedish)	21	19	16	£ per standard	24
Petrol (No. 1 Spirit)	15·5	17·5	13·5	pence per gallon	13
Beef (Argentine Chilled)	5/–	5·17	3·75 (June)	shillings per 8 lb.	25
Mutton (New Zealand frozen)	5.8	4.8	3·6 (July)	shillings per 8 lb.	38
Cheese (Canadian)	100	97	69	shillings per cwt.	31

available, the relative price movements of raw and finished goods between 1913 and the end of 1930.

Comparable figures cannot be given for other countries; but there is little doubt that these figures are typical—and the discrepancy in relative prices has become even greater since the end of 1930.

In conclusion, then, it is plain enough that, if industrial prosperity is to be successfully restored and maintained, the problem of the instability of prices must be solved. But absolute price stabilisation is neither desirable nor practicable; and the instability of prices is not due purely to monetary causes, or amenable to purely monetary remedies. Much could be done by a saner monetary policy to reduce price fluctuations; and we shall discuss ways of doing this at a later stage. But the roots of price instability lie deeper still in the structure and working of the economic system as a whole; and we must beware of those suggested remedies for our economic troubles which hold out to us the hope that all will be well as soon as the nations of the world adopt this or that particular nostrum as the foundation of their banking policy.

CHAPTER VI: MONEY, CREDIT AND CAPITAL

1. What is Money?
2. Credit
3. The Gold Standard
4. The British Banking System
5. Banking in the United States
6. Banking in Other Countries
7. The Control of Credit

§1. WHAT IS MONEY?

THE OUTLINE of the present economic system given in an earlier section avoided as far as possible all complications due to the behaviour of money. It was an attempt to get behind the money form in which, in every developed country, economic transactions are actually for the most part carried on to the underlying economic realities—the real things used up in the production of wealth and the real satisfactions enjoyed in its consumption. But we can clearly no longer afford to leave money out of account, both because it is almost everywhere the habitual means of exchanging goods and services and of providing for their production, and also because the behaviour of money has evidently been a most important factor in the economic events of the past few years. Indeed there are some people who go so far as to attribute almost all our economic difficulties to the misuse of money, and hold that everything can be put right by a change in monetary policy without making any fundamental alteration in the other aspects of economic organisation. These are the " currency cranks "

whose doctrines have at all times of economic distress exercised an extraordinary fascination over men's minds, so that whenever anything goes wrong with the industrial system it is safe to predict that a fresh batch of infallible plans for restoring prosperity by the manipulation of money will promptly make its appearance. But apart from the currency cranks there are many more reasonable people who attribute a large share in our present difficulties to money, and look to monetary reform more than anything else to set us once more on the road to prosperity.

This question of monetary policy is inevitably difficult for the layman to understand, and I shall accordingly be at more than the usual pains to simplify the presentation of this part of my subject. For it is so fatally easy to go stark staring mad in thinking and talking about money ; and those whom the madness grips appear to become fatally incapable of talking sense on any subject. Those readers who do understand the working of the world's monetary and banking systems must therefore pardon me if I seem to be telling them a great many things which they know perfectly well already. For it is quite unsafe to assume even an elementary knowledge of how the monetary mechanism works from the great majority of people.

The first and most obvious use of money in the modern world is to pay for the things which we need to buy from day to day—clothing, food, tobacco in the retail shops, a drink or a meal in a restaurant or a public house, a seat in a theatre or cinema—any or all of the small expenditures which make up the daily round of the ordinary citizen. A second obvious use closely related to the first is to pay wages. The manufacturer, the housewife who employs domestic servants, all the various types of employers of labour are accustomed to pay the wages of their employees in actual money ; and this money distributed in wages forms, of course, the major part of the money which is afterwards paid out by the consumers in meeting their day to day expenditure.

Currency and Other Forms of Money. The money spoken of in the last paragraph was actual money in the sense of *currency*—coins of silver or copper (for the world now hardly uses coins of gold) or bank notes made of paper. Money of this kind, which is passed freely from hand to hand and acceptable everywhere within the country of issue in payment for goods and services, is usually called *currency*. It is employed, as we have seen, mainly in the payment of quite small accounts, and most of it is constantly passing from hand to hand. Employers get it from the banks and use it to pay wages, wage-earners spend it and thus pass it over to shop-keepers, rent-collectors, insurance agents and a host of other business people. These in due course pay it back into the banks, and from the banks it issues forth again to perform the same round. This movement of currency from the banks into the hands of the consumers and back again is called the *circulation* of currency.

Currency, however, is no longer the only or even the main form of money in the most developed economic communities. For business people settle most of their accounts one with another without using it; and even the richer consumers as a rule use it only for small day to day payments, and meet a large part of their expenditure without employing it at all. Business accounts within a single country are usually settled by means of *cheques*; and the middle class consumer also keeps a cheque book which he uses for the payment of most of his bills. The great change that has come over the monetary systems of the world during the past hundred years consists simply in this use of cheques in place of actual currency for the settlement of an ever-increasing proportion of the total volume of monetary transactions.

When, however, monetary transactions take place, not within a single country, but across national frontiers, yet another kind of money is very often brought into use. All currency is national currency issued by the Government or by the banks of a particular country, and valid only within

a national frontier. If a man wants to make a payment outside his own country he cannot use the currency of his country for that purpose. If he goes abroad on a visit he has to change his own national currency into the currency of the country to which he travels. And if a merchant wants to pay for goods which he has bought from abroad, he also has somehow to supply himself with foreign money of one sort or another in order to make the payment. Individuals travelling abroad commonly supply themselves with actual currency of the countries which they visit ; but in international trade payments are to a great extent made neither with currency nor with cheques, but with a different instrument—actually older than the cheque—which is called the *bill of exchange*.

We shall have therefore, in our account of the monetary system, to deal not only with the currencies issued in the various countries but also with these other forms of payment —cheques and bills of exchange—which play so large a part in the world's commercial and industrial affairs. And the first thing that we must do is to get as clear as possible the differences and resemblances between these various forms of money and the relation in which cheques, bills of exchange and other substitutes for currency stand to the coins and notes which these other instruments of payment somehow represent.

Token Money. Let us begin with currency, and let us confine ourselves in the first instance to a single country, without considering the complications of the exchange of one national currency for another. The currency of a country consists, as we have seen, of coins made of metal and of bank notes or occasionally government notes made of paper. By far the greater part of this supply of currency is *token* money—that is to say it possesses no intrinsic worth corresponding to the money value stamped or printed upon it. It acquires its value, its power to purchase goods and services, from the circumstances under which it is issued. At one time, indeed, this was not supposed to be the

RELATIVE VALUES OF VARIOUS CURRENCIES AT PAR AND IN MARCH, 1932

Country	Unit	To the pound sterling in foreign currency per £ at par	Last week in March 1932	To the dollar in cents per unit of foreign currency at par	Average of March 1932
U.S.A.	dollars	4.866	3.697	—	—
U.K.	pounds	—	—	486.66	363.93
Germany	reichsmarks	20.43	15.44	23.82	23.78
France	francs	124.21	93.50	3.92	3.93
Italy	lire	92.46	70.75	5.26	5.18
Holland	florins	12.107	9.11	40.20	40.28
Czechoslovakia	crowns	164.25	124.05	2.96	2.96
Switzerland	francs	25.2215	19.01	19.30	19.34
Sweden	crowns	18.159	18.48	26.80	19.85
Japan	yen	9.76	11.29	49.85	32.16
India	rupees	13.33	13.22	36.50	27.31

case. Currency consisted of an actual weight of metal with the stamp upon it ; and this metal was supposed to possess real value corresponding to the value inscribed upon its face. For metal has a value of its own just like any other commodity, and this value depends on the demand for it in relation to its cost of production. But never, in fact, has the whole monetary circulation of any country really consisted of currency possessing an intrinsic or commodity value corresponding to the value assigned to it by the authority responsible for its issue. For, even if coins at the time of their issue do possess such an intrinsic value, they lose weight by wear and tear, and yet up to a point continue to pass current as if they retained their original intrinsic worth. There has, indeed, in the past, often come a point at which the currency has been so lessened in weight by wear and tear or by deliberate clipping that men have no longer been willing to accept it at its face value and have insisted on being paid by weight and not by tally. For many centuries this problem of the debasement of currency was one of the major financial problems of the civilised world. Moreover, debasement took place not only through wear and tear, and through the activities of clippers, but also by the action of Governments themselves. For it was an obvious expedient for a needy Government wanting to raise the wind to pay its debts in money that was worth less than the value which the Government itself caused to be inscribed on its face. But for many centuries, in theory at least, the currency circulating in the hands of the public was not token money but actual metal deemed to possess an intrinsic value corresponding to that of the goods it was used to purchase, usually minus a small charge or *seigniorage* made for its issue by the Government concerned. Gradually, in order to prevent clipping, improvements were introduced into the design of coins. Milled edges, for example, were largely effective in defeating the clipper ; and gold owes its pre-eminence as the metal of which the most valuable currencies are made not only to its scarcity and high intrinsic value but also to its

ability to stand wear and tear with the minimum of loss.

All through the Middle Ages Western Europe was perpetually short of currency—short, that is, of the metals of which currency was made. This shortage had a powerful effect in keeping down prices; for, if a limited supply of money had to be used to buy an increasing quantity of goods, prices were bound to be low. Each piece of money had to buy more goods than before, as the supply of goods increased. The discovery of America and the vast influx of the precious metals from the New World caused a tremendous rise of prices throughout Europe and was accountable for many of the economic upsets and social disturbances of the following century. Similarly in the nineteenth century the discovery of new goldfields in California and Australia about 1850, and the opening up of the South African goldfield towards the end of the century, both caused a sharp rise in the price level. Some people think that to-day the root of our troubles lies in the failure of the gold supply to expand in the right proportion to the recent growth of the world's productive power.

What has been said so far would seem to suggest that the intrinsic value of the metal used as currency is after all a matter of fundamental importance. For clearly a shortage of gold or silver would not matter if it were within the power of Governments to meet it merely by reducing the intrinsic value of the coins in circulation by alloying the precious with baser and less valuable metal. The fact is that, up to quite recent times, the intrinsic value of the money in circulation did matter; and the power of Governments to give the money which they issued a purchasing power in excess of the value of the metal embodied in it was narrowly limited. For the coins actually in circulation were not exchangeable into anything else except the goods which they could be used to buy; and men could not therefore be prevented from putting their own valuation upon them in accordance with the intrinsic worth of the metal which they contained. But to-day it is safe to say that the intrinsic value of the coins and other forms of currency

in circulation does not matter a jot; and it is of the greatest importance to understand how this change in men's attitude to money has come about.

Bank Notes. We shall understand it most easily if we consider for a moment the nature, not of coins made of metal, but of the other form of currency most in use in the modern world—the bank note. The bank note is in its origin simply a promise to pay—a promise by the bank which issues it to pay in actual metal coins on demand to its possessor the amount written on its face. The value of a bank note therefore depended essentially on the confidence felt by those through whose hands it passed that the issuing bank would, if called upon, actually redeem its promise. In Great Britain little more than a century ago bank notes were being issued not only by the Bank of England but by local or "country" banks in all the leading provincial towns. Some of these banks were large stable concerns, with ample resources behind them, whose promises to pay were generally trusted; but many others were mushroom concerns which had sprung up in response to the demand for an additional supply of currency that arose clamantly during the Napoleonic Wars. For at that time prices were increasing fast; and the expansion of productive activity following upon the Industrial Revolution was in full swing. In those days most bank notes had only a local circulation. They were only acceptable within a relatively small area within which a particular bank was known; and quite often a bank note might be worth less for the purpose of buying goods than its face value, because of a lack of confidence in the solvency of the particular bank which had issued it. There were, in fact, a great many bank failures; and many unfortunate people found themselves in possession of paper money which had lost all its value. Gradually the inconveniences of this situation were realised, and steps were taken to concentrate the issue of bank notes as nearly as possible in the hands of a single bank. Under the Bank Charter Act of 1844 the Bank of England secured, not

indeed a monopoly of note issue, but something approaching it ; for the issues of the country banks were limited to the amount of notes actually outstanding at the time in their names, and provision was made for the gradual extinction of these country issues, only the leading Scottish banks retaining a separate and limited right of note issue.

In England the bank note thus came to be a promise by the Bank of England to make payment, and the stability of the Bank of England came to be generally regarded as a guarantee that this payment would actually be made whenever the possessor of a bank note wanted actual gold in exchange for it. But this security was procured only by limiting the right of the Bank of England to issue notes. The Bank was not allowed to issue as many notes as it chose. For the most part it had to have actual gold in its cellars as a backing and guarantee of exchangeability for its notes, and the amount in notes which it was allowed to issue in excess of its stock of gold was strictly limited to £14,000,000 —a sum gradually increased to nearly £20,000,000 as the note issues of the country banks lapsed into its hands. Apart from this £20,000,000, every note issued by the Bank of England was backed by an equivalent in actual gold lying in the cellars of the Bank ; and there was accordingly under normal conditions no doubt at all about the Bank's ability to pay out gold in exchange for its notes. There did indeed remain the possibility in times of panic of such a run on the Bank as would completely exhaust its gold stock ; and several times after the passing of the Bank Charter Act the obligation of the Bank to pay out gold had to be temporarily suspended at moments of financial crisis. Normally, however, there was no doubt of the Bank's ability to pay ; and people came to regard a Bank of England note as fully equivalent to the gold which it effectively represented.

Indeed, the value of the Bank of England note under the new conditions was a good deal more secure than that of the actual gold coins which had circulated in earlier times. For the Bank promised to pay out gold in exchange for its

notes at full weight, and there was no risk of loss through having to accept debased coins. Bank notes thus came to circulate quite freely side by side with money made of metal ; and the bank note with an adequate guarantee of exchangeability behind it gradually got people out of the habit of thinking that it was necessary for their money to possess an intrinsic value corresponding to its purchasing power.

Money and Gold. This notion, however, took a long time to disappear—and perhaps it has not completely disappeared even now. All through the latter part of the nineteenth century the British sovereign was esteemed highly because it did actually contain an amount of gold corresponding to the value of the goods it could be used to buy ; and though the use of golden money has now been abandoned over practically the whole world there is still in some countries—in France, for example—some sign of a hankering to return to the old system. In relation to the smaller coins of silver and copper the idea of token money has been universally accepted, and there is, in fact, very little possibility of the world returning to the use of gold money. The hankering after actual gold is little more than a lingering superstition ; and nowadays most people are prepared to recognise that token money is quite as good as any other provided that the maintenance of its purchasing power at a reasonable level is adequately guaranteed by the authority which issues it.

The coming of the bank note has thus gradually taught the world to accept token money and to recognise that currency in the modern world owes its value not to the stuff of which it is made but to the circumstances under which its issue takes place. We have seen how the shortage of the precious metals in the mediaeval world kept prices down, and how again and again in the world's history fresh discoveries of the precious metals, by increasing the supply, have caused a rise in the level of prices. If the world takes to using token money instead of money possessing an intrinsic

value, clearly the purchasing power of this money will be no less dependent on the quantity of it supplied in relation to the work which it is called upon to do. If, for example, a modern Government chose to pay all its bills simply by printing additional supplies of paper money, and thus constantly brought fresh currency into circulation without recalling the old, the level of prices would obviously rise just as it rose after the opening up of America or after the discovery of gold in California or South Africa. If the world is to use token money, the supplies of this money must be regulated in accordance with some definite principle if it is to retain its purchasing power. The world has seen in recent years, in the great movements of inflation in Germany, Austria, France and other countries, what happens when the supply of paper money is increased out of all relation to any increase in the supply of goods or in the volume of transactions needing to be financed.

In the modern world, however, currency does not stand alone ; for, as we have seen, actual coins and bank notes are customarily used only for payments of certain kinds, and by far the larger part of the world's business transactions is financed without any use of currency, apart from the sums which are used in paying wages. Whereas, therefore, there used to exist a quite simple relation between the volume of currency issued, the volume of goods produced, and the price level, this relation is by no means so simple to-day. For it is necessary in the modern world to take account of the supply, not only of currency, but also of other means of payment such as cheques and bills of exchange. The banker of a hundred years ago did most of his business —as far as internal transactions were concerned—in actual notes and coins. The banker of modern times does most of his by means of book entries involving directly no movement of currency at all. When A writes a cheque to B no currency need change hands. A's account in the bank is written down by so much ; and B's, in the same or another bank, is written up by an equivalent amount. Moreover, when a bank lends money in the modern world it usually

lends not coins or notes but the right to draw cheques, and here again no movement of currency is necessarily involved, although of course such movements may result indirectly. It is therefore indispensable to understand the relation which exists, in our modern financial system, between currency and what is commonly called credit—the means by which the larger economic transactions are now habitually financed.

§2. CREDIT

IN JANUARY 1932 the total amount of Bank of England notes in existence was under £400,000,000, and of these only £353,000,000 were actually in circulation. On the other hand the deposit accounts of the London Clearing Banks alone amounted to £1,714,000,000 ; and the figures of *daily* bank clearings issued by the London Bankers' Clearing House came to over £98,000,000. At the same time, in the United States the total of all kinds of currency in circulation was \$5,647,000,000, whereas the total deposits of all the banks amounted to \$46,261,000,000. The sums on deposit in the banks and the sums changing hands in the course of a year were thus vastly in excess of the amount of actual currency available. In other words, most of the financial operations of the country were being financed not by the passing of currency from hand to hand but by the movements of deposits within the banking system. Of what, we have now to enquire, does this enormous volume of bank deposits consist ? Clearly it does not consist of actual currency ; and, if all the depositors in the banks tried simultaneously to exchange their deposits for currency, every bank in the country would immediately have to close its doors. This is true not only of the British banking system but of every banking system in the modern world, though not of all to the same extent. For everywhere a large proportion of business transactions takes place nowadays without any use of currency.

Bank deposits are like bank notes in this—that they consist of promises to pay on the part of the banks. If I have a deposit of so much in one of the joint stock banks or in the Bank of England itself, this means that I am entitled to write cheques up to the amount of my deposit, or alternatively to go to the bank and demand actual currency up to that amount. But the bankers know that their depositors will only demand currency to a limited extent and will actually settle a large part of their transactions by the writing of cheques. They know, moreover, that even when a depositor does demand currency—say, for the payment of wages—this currency will for the most part be speedily returned to the banking system through the tradesmen to whom its wage-earning recipients will pay it away. It is therefore necessary for them to keep in actual currency only enough to meet the demands for it which they think are likely to be made upon them; and in practice this amounts only to a very small proportion of their total deposits. Each joint stock bank, in addition to the actual currency in its hands, keeps an account with the Bank of England, and can at any moment call upon that Bank for an additional supply of currency. But even if the deposits of the joint stock banks at the Bank of England and their own stocks of coins and notes are added together, they amount only to a fraction of their total obligations as represented by the deposits of their customers. Thus in January 1932 the London Clearing Banks had together, in coin, notes and balances at the Bank of England, just under £180,000,000—or not much more than one-tenth of the amount of their deposits. They knew, however, that under all normal conditions this would give them a supply of currency ample enough to meet all the demands for it that were likely to be made.

Bankers' Cash Reserves. The joint stock banks have indeed always the power of increasing their cash balances beyond this proportion of one in ten if they see the need; for they can always either sell some of their assets for cash, or

call in some of their short-term loans. Thus in January 1932 the London Clearing Banks had £283,000,000 worth of investments and £117,000,000 worth of money at call or short notice; and they could at any moment by reducing these items have increased their cash reserves by paying into the Bank of England the cheques received from the sale of investments or the repayment of short-term debts. But the banker does not want to keep his cash assets at a higher figure than is necessary; for whereas his investments and loans bring him in interest, and thus serve to increase his profits, he gets no interest on the sums which he keeps in cash or lying at the Bank of England. He has therefore a strong incentive to keep down his cash resources to the lowest possible point; and he has found by experience that the proportion of one in ten is, under normal circumstances, fully enough.

Bank Deposits. Of what then do these vast deposits that are not backed by currency or accounts at the Bank of England really consist? They can be divided into two categories, though, as we shall see, these categories are not truly so distinct as they seem. They consist, first, of sums paid in by the banks' customers, and secondly of loans granted by the banks. Primarily the business of the joint stock banker is to look after other people's money, which they deposit with him for safe keeping and convenience of transfer. His own capital forms but an insignificant part of the sums with which he operates. Thus the total capital, including accumulated profits, of the nine London Clearing Banks in January 1932 amounted to no more than £123,000,000, compared with deposits of £1,677,000,000, and loans of £889,000,000. By far the larger part of the banks' resources consisted of sums which their depositors had left in their keeping. These sums might be paid in by the depositors either in actual currency or by way of cheques drawn on the same or other banks. The banker undertakes the safe-keeping of these deposits, and guarantees to let the depositor draw on them at will either without

notice (current accounts), or subject to a short period of notice (deposit accounts in the narrower sense).

But the banker also agrees to let his customers draw cheques or receive actual currency in excess of the amount which they have paid in. That is to say, he grants loans or advances—overdrafts, as they are commonly called—usually demanding the deposit of securities against his loans. Every time a banker grants a loan in this way the effect is to write up the amount of the deposit accounts of his customers. It pays him to grant these loans because he receives interest upon them, and he can grant them with safety as long as they do not mount up to such a point as to cause a demand for currency in excess of the available supply, and further as long as he does not get out of step with other bankers in the magnitude of the loans which he makes.

Bank Advances. When a banker grants a loan and thus writes up the amount of money lying to the credit of the customer to whom the loan is made, he does this in the expectation that the borrower will speedily draw out the sum thus placed to his credit; for clearly a borrower would not be prepared to pay interest on the loan unless he wanted to spend the money. As soon, however, as the borrower does draw the money out, either by writing cheques or by taking currency from the bank, the amount standing to his credit is again written down, so that the volume of the bank's deposit accounts is again decreased. The sums, however, which the borrower thus draws out he proceeds to transfer to other persons—businesses to which he owes money or workmen whom he employs—and this money is then paid back into the banking system by those who receive it. The result is that, almost as soon as the borrower's account is written down, other accounts are written up to a corresponding extent; and the sums actually paid into the banks by depositors thus come to consist largely of loans which the bankers have made. That is why the two elements which go to make up the total

of deposits in the banks are not really so distinct as they seem. For a loan by a bank not only creates a deposit when it is made, but reappears in the deposits subsequently made by those to whom the borrower pays the money away. It is thus quite impossible to disentangle in the financial statements of the banks those sums which represent deposits made by the banks' customers—apart from bank loans—from deposits which are the direct result of bank lending. The banker, indeed, is not concerned with the making of any such division ; all he has to consider is, in the first place, whether the amount of currency available for his use is adequate, and secondly, whether he is keeping in step with the loan-granting policy of the other banks. Of course he has also to consider whether the particular person who wants to borrow money from him is a suitable person to receive the loan ; but we are here considering, not the particular destination of bank advances, but only their total amount.

It is necessary for the banker to keep in step with the policy of other banks for a very simple reason. If all banks are making loans roughly in the same proportion to the total volume of their deposits it is probable that the amounts which each bank will be called upon to pay away to other banks will approximately correspond to the amounts which other banks will have to pay to it. The leading banks, in London for example, maintain a Clearing House through which they cancel by a mere system of book-keeping their debts one to another arising out of the cheques drawn by their depositors. If the sums due from bank to bank cancel out, the matter is settled without any actual payment taking place ; but if one bank owes another a balance this is settled almost as simply merely by the transference of the required sum from the account of one bank in the Bank of England to another. If, therefore, a bank, by lending more freely than the rest, found itself with a considerable debit balance to meet, the effect would be to decrease its balance at the Bank of England, while writing up the balance of the other banks. It would therefore find itself with a decreased

supply of cash ; for as we have seen, the joint stock banks treat their balances at the Bank of England as the equivalent of cash. This fall in the bank's available supply of cash would in turn restrict its ability to lend ; for its cash ratio would be driven down below the 10% which the banker normally thinks it desirable to keep as a minimum reserve. He would therefore restrict his lending until the ratio was restored ; and in this way the lending policy of the various joint stock banks is in fact kept practically uniform.

Do Banks Create Credit? The mass of purchasing power that is in circulation in the community at any time thus consists very largely of bank money which is transferred from hand to hand by means of cheques. This bank money includes both sums belonging to the depositors in the joint stock banks—individuals, business houses and institutions of all kinds—and also the loans made by the banks to these depositors. There has been a good deal of controversy about the nature of these loans. The bankers have often maintained that it is a fallacy to suppose that they *create* credit, and that in fact they do no more than transfer the idle deposits of some of their customers to other customers who are in a position to make use of them and prepared to pay for their use ; but it is in fact quite impossible either for any outsider or for the banker himself to know when he is merely transferring credit and when he is creating it. For, as we have seen, the deposits lying in the accounts of the bank's customers include the loans granted by the banking system ; and it is impossible for the banker to tell when he is lending "real money" and when he is lending money which he himself has created. The very question is indeed meaningless in relation to modern banking practice. The banker can himself, of course, lend more or less, and by his lending increase or decrease the available amount of purchasing power ; but it is impossible to distinguish between the credits which he creates and those which he merely transfers. What concerns him is the relation not between loans

and deposits but between the total volume of deposits, including loans, and the cash resources at his command.

In these circumstances it is simplest to speak of the banks as creating credit whenever they make a loan, without implying either that the credit is being created out of nothing or that it is being transferred ; for, beyond dispute, the banker does *create* credit in the sense that by lending he increases the current supply of purchasing power whereas by not lending he decreases it.

The explanation of this is quite simple. Even if the banker is regarded as merely transferring credit, and not as creating it out of nothing, the effect of his action in transferring it is to increase the activity of the money and to cause it to circulate more rapidly than it would without his intervention. At any time a certain number of the banks' depositors are leaving their money lying idle in the banks. If the banker then lends money to people who will at once use it to buy things there is more money in effective circulation on account of his action, even if the total amount of money were not also increased.

The Quantity Theory of Money. This brings us to a very important conception which affects the whole relation between the supply of money and the level of prices. Economists usually call this conception the " velocity of circulation " ; and it is a vital part of the theory known as the *Quantity Theory of Money*. According to this theory, the price level depends on the relation which exists between the amount of money in active circulation and the amount of things of all sorts needing to be bought and sold. But just as the goods and services, in order to affect the price level, must actually change hands—for a house or a picture that is not being offered for sale has no effect on prices—so money will only influence the price level if it actually changes hands. When an Indian rajah or an Indian peasant hoards money in his treasury or buries it in his garden, that money, as long as it continues to be hoarded, ceases to count as money so as to exert an influence on the level of prices.

There are enormous hoards of gold and silver hidden away in the Far East; and we have seen in the early months of 1932 some of this money coming out of the Indian hoards, and exerting a powerful influence on the value of the pound sterling. In rather a different way we have seen America and France in recent years absorbing into the vaults of their Central Banks large quantities of gold which they have not actually used as a basis for currency; and this gold has been similarly locked away so as not to count as money and not to affect the current level of prices except, of course, by making it lower than it would be if this potential money were actually in use.

If, then, money which does not circulate at all has no influence on prices, it follows that money which circulates fast has more influence upon them than money which circulates slowly; for it does more work. If money passes quickly from hand to hand, performing on each occasion a service in the carrying through of an act of exchange, the same money, being used again and again, exerts an influence on the price level proportionate to the number of times it is used. Under normal conditions this velocity of the circulation of money depends on the established habits of a community and is not subject to large changes, but under exceptional conditions the velocity of circulation may be either greatly speeded up or greatly decreased. If, for example, people expect prices to rise sharply, this means that they anticipate that the longer they keep their money in their hands the less it will be worth in terms of goods. They are therefore anxious to use it at once in buying things which will become more valuable as the value of money declines. The velocity of circulation is thus increased; and the effect of the increased velocity is to make prices rise faster still. This happened to an astonishing extent in Germany at the time of the great inflation, and the inflation itself was largely the result of this enormous increase in people's anxiety to get rid of their money in exchange for goods as quickly as they possibly could.

On the other hand, if people expect prices to fall they

look forward to their money increasing in value by being kept ; whereas if they use it to buy things the goods will be worth less in terms of money in the future. They are therefore inclined to hold off from buying things until they think prices have touched bottom ; and the velocity of the circulation of money is thereby greatly slowed down, and the tendency of prices to fall accentuated by the slowness with which money changes hands. This decrease in the velocity of circulation has occurred all over the world during the present slump, and has reached the greatest dimensions in the United States of America where, in addition to the slowing down in the rate of turn-over of bank deposits, there has been an actual hoarding of currency based on the fears aroused by wide-spread banking defaults. The American banking system, in order to counteract the effects of this hoarding of money and the decrease in its velocity of circulation, has been impelled to create an additional supply of currency by bringing a larger part of its gold resources into operation as a basis for the issue of bank notes. It has thus to some extent checked the fall in prices ; but it has been unable to counteract the tendency towards hoarding and decreased velocity : so that the additional supply of money made available for the American public has not prevented prices from moving downwards even in face of a large decrease in the current production of goods.

Money and Prices. On the face of the matter the idea that the level of prices follows directly from the relation between the quantity of money and the quantity of things needing to be exchanged seems to be a matter of plain common sense. But from what has just been said it will be realised that in practice the relation is far more complicated than this. For it is not the amount of money only, but the amount multiplied by its effective rate of use, that influences the price level from the money side. Nor is the quantity of things needing to be exchanged nearly so simple a notion as it sounds. For the things that are at any time changing hands in the community are not only the goods

and services that are being currently produced but also a quite uncertain and variable proportion of the things already in existence. People buy and sell not only newly produced goods and current personal services but also land, houses, second-hand goods of all kinds and above all stocks and shares. Money is needed for the purchase of these second-hand goods just as much as for current production ; and accordingly an increase in the proportion of second-hand goods that are being bought and sold will affect the price level to as great an extent as an increase or decrease in the supply of money. Thus a boom on the stock market or in real estate will probably cause a much larger volume of stocks and shares or of land to change hands ; and this will create a need for additional money in order to finance the increased turn-over. It is true that a speculative boom will also increase greatly the velocity of circulation of the kinds of money that are used in stock market and real estate operations—that is to say, mainly short-term bankers' credits—and therefore the increase in the quantity of money required will be much less than the increase in the money value of the transactions needing to be financed. But some increase in the quantity of money there will need to be, unless so much of the available money supply is to be locked up in stôck market operations as to force down the level of commodity prices by leaving less funds available for their purchase. A stock market boom is therefore accompanied by a considerable increase in the volume of bank credit ; and this increase is apt to be the larger because loans granted by the banks for the purpose of current production are diverted into stock speculation, and the banks are then induced to grant more credits for production in order to avoid the danger of an industrial depression. It may be argued that the banks ought to be able to prevent this diversion of funds from the financing of production to use in speculation ; but in fact no banking system seems yet to have devised means of checking speculation without at the same time witholding advances from industry, and thereby causing production to decline. Certainly the American

system did not succeed in doing this during the boom of 1928 and 1929, although its controllers tried ; and bankers as a class are very much disposed to argue that it cannot be done at all.

The relation between money and prices is thus far more complicated than it appeared at first sight ; and the Quantity Theory of Money, while it remains fundamentally true and even a truism, is not really of much help in the formulation of financial policy. Clearly the job of the banking system should be to provide the community with just enough money to keep its productive resources fully employed—no more and no less—and to avoid all upsets in the value of money that are likely to lead either to a speculative boom or to depression resulting from the disturbance of established monetary expectations. But this result certainly cannot be achieved by any mere rule of thumb application of the Quantity Theory. Before we can hope to see how the banking system can set about achieving it we must look more closely both at the ways in which the supply of money of all sorts is at present regulated and at the actual structure of the banking system through which this regulation takes place.

§3. THE GOLD STANDARD

IN THE foregoing section a distinction was drawn between two kinds of money—actual currency consisting mainly of bank notes and also of coins used principally for small change, and bank money made up of deposits lying to the credit of the banks' customers in their accounts, and including advances made by the banks as well as sums actually belonging to each depositor. This distinction between currency and bank money is of vital importance, for in every country the amount of bank money that the banking system is able to create depends in some degree on the amount of currency available for use ; and, on the

other hand, the amount of currency required depends, though in a more complicated way, on the amount of bank money in circulation. In nearly all countries nowadays currency is put into circulation chiefly through a special sort of bank known as a Central Bank, and this Central Bank operates under regulations laid down for it by Act of Parliament and usually under some form of government control, in fact if not in theory. On the other hand, by far the largest part of the bank money in use is put into circulation not by the Central Bank but by a number of other banks, usually known as joint stock banks or deposit banks, in which the majority of individuals and business houses keep their accounts. There are also, as we shall see later, other and more specialised types of banks and financial institutions which play an important part in the effective circulation of bank money. But let us for the moment confine ourselves to considering the rôle played on the one hand by a typical Central Bank and on the other by the group of deposit or joint stock banks connected with it within a single monetary system. Broadly speaking, the main function of a Central Bank is usually the regulation of the supply of currency under the restrictions and conditions laid down in the Act of Parliament or Congress from which it derives its powers. But this regulation of the supply of currency also involves to a great extent the regulation of the total supply of bank money; and the joint stock banks in their lending policy have in fact to be governed largely by the attitude of the Central Bank. With varying degrees of strictness in different countries, the Central Bank is able to control the total volume of the lendings of the joint stock banks; and the function of these latter is rather to distribute at their discretion among the different applicants for loans the amounts which the Central Bank allows them to lend than to determine how much their total lendings shall be. This is only true up to a point, for in every banking system the joint stock banks have some power to vary the total amount of their lendings even against the wish of the Central Bank; but especially in Great Britain it is broadly true that the

Central Bank controls not only the supply of currency but also the total supply of bank money available for lending. This gives us three principal functions of the banking system to consider—first, the regulation of the currency; secondly, the regulation of the total supply of bank money; and thirdly, the allocation of the available bank money among the different applicants. Let us begin with currency, and with the structure of the Central Banks through which the currency is issued to the public.

The Gold Reserve. It is easiest to take a concrete example. In Great Britain the Bank of England is to all intents and purposes solely responsible for the issue of currency; for neither the separate rights of issue of the Scottish banks nor the fact that coined money issues originally from the Mint and not from the Bank really affect the position. The power of the Bank of England to issue currency is regulated by Act of Parliament, and has been ever since the Bank Charter Act of 1844. Indeed, right up to 1914 the conditions laid down in the Bank Charter Act of 1844 remained in operation without change—a continuity of policy which was possible only because during the nineteenth century the money-using habits of the community fundamentally changed. The position was that the Bank was entitled to issue roughly £20,000,000 worth of notes without gold backing, but that for every note over and above this £20,000,000 it had to have a pound for pound backing in gold. British five-pound notes, which circulated side by side with golden sovereigns issued from the Mint, were thus nearly all backed fully by gold. But the war changed all that. The circulation of gold money ceased at once in August 1914, and the obligation of the Bank to give gold in exchange for its notes at a fixed value was also suspended. The Government itself issued a new paper currency of Treasury notes which were not fully backed by gold, and as prices rose the number of these Treasury notes rapidly increased, until the major part of the currency in circulation came to consist of paper without gold backing. This

GOLD RESERVES OF THE LEADING COUNTRIES

			1922	1924	1926	1928	1929	1930	1931
United States	dollars	millions	3,929	4,499	4,492	4,141	4,284	4,593	4,460
France	francs	„	20,355	20,407	20,425	31,838	41,622	53,563	68,863
England	pounds	„	155	156	151	153	146	148	121
Germany	reichsmarks	„	1,062	819	1,897	2,795	2,349	2,282	964
Belgium	francs	„	1,866	1,889	3,101	4,517	5,876	6,862	12,749
Holland	gulden	„	582	505	414	435	447	426	887
Switzerland	francs	„	535	506	472	533	595	713	2,347
U.S.S.R.	gold roubles	„	5	142	164	179	286	484	638
Poland	zloty	„	87	178	237	621	701	562	601
Italy	lire	„	6,286	6,315	6,049	6,888	7,003	7,081	7,399
Australia	pounds	„	46	47	50	49	41	18	11
Canada	dollars	„	240	208	230	191	151	194	143
Argentine	gold pesos	„	505	470	476	641	461	435	262
Brazil	milreis	„	384	450	471	1,242	1,257	129	—
India	rupees	„	324	298	298	340	351	346	444
Japan	yen	„	1,215	1,175	1,127	1,085	1,087	838	470

GOLD RESERVES OF LEADING CENTRAL BANKS ONLY IN MARCH 1932

(in millions of dollars)

Central Banks of	Holdings at end of March 1932	Change from a year before
England	588	−118
France	2,999	+800
Germany	209	−336
Italy	296	+17
Belgium	349	+149
Holland	352	+173
Switzerland	471	+347
United States	3,020	−95

NOTE.—This Table excludes gold held by Governments or other Banks. Including Government holdings, the United States had \$4,051,000,000, and including other holdings a total gold stock of \$4,389,000,000. In other countries, Government holdings are unimportant, and most of the gold is concentrated in the Central Banks. It may be added that between January 1931 and March 1932 the Bank of France reduced its holdings of foreign currency by \$547,000,000.

Government money remained in circulation side by side with Bank of England money for some time after the war; but in 1928 the note issues of the Treasury and the Bank of England were amalgamated under the unified control of the Bank, and new conditions were laid down by Act of Parliament for the regulation of this unified issue of bank notes. Thereafter the Bank of England was empowered to print not £20,000,000 but £260,000,000 worth of notes without gold backing. This sum was called the fiduciary issue; and there was power in emergency for it to be increased on the application of the Bank to the Government, and subject to the authorisation of Parliament. But, apart from this emergency provision, the Bank of England had still to have a pound for pound gold backing for every note issued in excess of the £260,000,000 constituting the fiduciary issue. This is one way of regulating the amount of currency that may be put into circulation—by prescribing by law a fixed maximum fiduciary issue, and insisting that all notes issued beyond this maximum shall have a pound for pound backing in gold.

But there is an alternative system, which is in fact applied by a larger number of countries. This is the system of a *proportional reserve of gold.* Where this applies there is no fixed fiduciary issue, but simply a provision that the Central Bank must have in its vaults against all notes issued a certain minimum percentage of gold—for example, 40%. The United States and Germany and many other countries work under this system of a proportional gold reserve. Some of the smaller countries, for reasons which we shall see later, have adopted yet another arrangement. They lay down that their Central Bank must hold against all notes issued a proportional reserve, not necessarily in gold, but either in gold or in deposits held in the banks of the leading countries. This is known as a *proportional gold and gold exchange reserve.*

The Importance of Gold. It will be seen that in all these various forms of Central Bank regulation the amount of currency that may be issued is made to depend in

one way or another on the supply of gold held by the Central Bank, or in the case of some of the smaller countries on the supply obtainable by it at need. Gold thus plays a part of fundamental importance in the regulation of the world's currency systems. In fact the world is endeavouring for the most part to work under what is called the gold standard, although a large number of countries have been compelled in one way or another to suspend the operation of this standard in consequence of the world slump. The gold standard was already the basis of the regulation of currency over most of the civilised world before the war. In the course of the nineteenth century one country after another followed Great Britain in adopting the gold standard as the basis of its banking system. Previously silver had been, either by itself or in conjunction with gold, under a bimetallic standard, the basis of the currency of a large number of States—as it was in Great Britain during the eighteenth century. But silver was liable to large fluctuations of value, both absolutely and in relation to gold ; and, as the trading relationships between the countries of the world became more organised, and international trade grew rapidly in importance, it was found more and more inconvenient not to have a single standard of monetary measurement applicable to all the leading countries between which things were being exchanged. Accordingly, one after another the industrial nations adopted gold as a standard, by basing the regulation of their various currencies upon gold. This was made possible only by a great increase in the world's gold supply during the latter half of the nineteenth century ; for, but for the discoveries of gold in America, Australia and South Africa, the general adoption of the gold standard would have caused so great a run on the available supply of gold as to force up its price and therefore to force down the prices of goods and services to an intolerable extent. Even as matters were prices fell sharply during the period when the gold standard was spreading most rapidly to new countries. Germany, the United States and the Latin Union all adopted the gold

standard in the course of the 1870's; and it was at the same time that there began the great fall in prices which lasted through almost the whole fourth quarter of the nineteenth century. Thereafter the great increase in South African gold production and some economies in the currency-using habits of the world reversed the tendency, and prices rose between 1896 and 1914. But these two sharply contrasting movements of prices were not sufficient to shake the faith of the world's financiers in the gold standard. They believed in it in 1914, and after 1918 the belligerent countries which had been driven off it by the exigencies of war aimed at getting back to it by mutual agreement as fast as they could. Some time before the world slump of 1929 nearly all countries had achieved this in some form; and the gold standard was again in full swing when the slump arrived, though, as we shall see, it was working and being worked in many respects in a different way in consequence of the changed economic conditions of the post-war world.

The Gold Standard Defined. What is the gold standard? And why has it been thus prized, so that nations have been willing to undergo great hardships and difficulties in order to get back to it? In any given country that is on the gold standard it consists in the equivalence of the national money to a certain fixed weight of gold of a certain fineness. Before the war this was secured by using actual gold coins of a weight and fineness prescribed, and by making such paper money as there was in circulation exchangeable on demand at the Central Bank for gold coin or bullion of this same weight and fineness. Now that gold coins have disappeared from circulation, the gold standard consists essentially in the exchangeability of paper money for a fixed amount of gold. When Great Britain went off the gold standard in September 1931, all she did in fact was to suspend the obligation of the Bank of England to give a fixed quantity of gold in exchange for its notes.

Obviously, if the national money of each country is exchangeable for a fixed quantity of gold, the national

moneys of different countries must be exchangeable for one another at a ratio closely corresponding to the amounts of gold which they contain. This ratio is not, indeed, absolutely fixed. It can, under the full gold standard, vary to the extent of the cost of getting gold in one country in exchange for notes and transporting the gold to the other country into whose money the exchange is to be made. The *rates of exchange* of the moneys of two countries which are both on the gold standard can therefore vary within the limits set by the cost of transport, including insurance, of the gold from one country to the other. The limits thus set to the fluctuations of the rates of exchange are called the *gold points*, and in practice the exchanges fluctuate within these points in accordance with the day to day ebb and flow of the demand for the one currency in exchange for the other. If more people want to change pounds sterling into dollars than dollars into pounds sterling the rate of exchange will tend to move against Great Britain—that is to say, the pound sterling will tend to be worth rather less in dollars. But it cannot be worth much less under the full gold standard ; for the cost of transporting gold from London to New York or from New York to London is very small in relation to the value of the gold.

Advantages of the Gold Standard. There are obviously great advantages in this fixing within narrow limits of the rates of exchange between different national moneys ; for it enables business men to make contracts and incur debts across national frontiers without worrying themselves about possible changes in the relative values of the national moneys concerned. A man can make a contract under such conditions in pounds or in dollars almost indifferently, for he knows in terms of his own currency how much he will have to pay or to be paid. On the other hand, when the world is off the gold standard and there is no fixed relation between the values of different national moneys, an element of great uncertainty is introduced into all contracts of an international kind ; for no one knows

when he contracts to receive or buy in foreign money in the future how much of his own money he will actually get or have to pay out. This uncertainty hampers both trade and the overseas lending of capital, and the world suffered great inconvenience from it in the years immediately following the war. There is accordingly nothing surprising in the strong desire which was felt by influential sections of the community in all countries to get back to the gold standard. Nor is it surprising that this desire was felt most strongly of all by bankers and financiers, who are of all men most concerned with the exchanging of money across national frontiers, and most likely to have their calculations upset by unforeseen changes in the relative value of different national moneys. For business men, as we shall see, the gold standard has had serious disadvantages as well as advantages ; but to the banker the advantages have been throughout by far the more obvious. It was the banking community above all that took the initiative in forcing the world back on the gold standard after the war.

In all this, it will be observed, nothing has been said about the maintenance of a gold reserve against the currency in circulation within a country. In order to remain upon the gold standard, a country needs to have at the disposal of its Central Bank enough gold to ensure the convertibility into gold of all national money that its holders actually desire to convert. It must be prepared to pay out gold for export to other countries to anyone who asks for it and to receive a fixed amount of national moneyin payment. But in fact under normal conditions the demand for actual gold for export is usually very small, for it does not pay to move gold from country to country until the exchanges between two national moneys have moved actually to the point at which it is worth while to incur the cost of transporting gold from the one to the other. But as a rule, before the exchanges have moved so far, steps have been taken by the Central Bank of the country to which the exchange is adverse to rectify the position—usually by offering a higher rate of interest in order to encourage an inflow of

foreign money. Under normal conditions, therefore, not much gold does actually pass from one country to another ; and, if conditions were always normal, a much smaller gold reserve than countries are accustomed to keep would be amply enough to meet all needs. Conditions, however, are not always normal, and above all have not been normal in recent years. Very large movements of gold have taken place even when the exchanges have been at such a level that it did not really pay to move gold. This has happened chiefly for two reasons. The first reason is that since the war certain countries, notably France have held large balances lying abroad in the banks of other countries. These balances were accumulated at the time when the French franc was greatly inflated and steadily declining in value ; so that a " flight from the franc " occurred, and French banks as well as French capitalists deposited a large part of their resources abroad. Since the franc was stabilised there has been proceeding a gradual repatriation of these balances, and this movement has been speeded up whenever the French have felt more than usually nervous about the stability of the currencies or banks of the countries in which their money was lying. Repayment to France has been made largely in gold ; and accordingly gold has silted up steadily in the coffers of the Bank of France.

The second reason is that the world now owes very large debts to the United States of America and, unable to meet these debts by building up a surplus of exports, has been compelled to make payment largely in gold. Gold has thus silted up in America as well as in France ; and for these two reasons the movement of gold from country to country has been since the war on an altogether unprecedented scale.

The Scramble for Gold. The Central Banks of the various countries, in order to meet the danger of a run on their money, have therefore felt a strong desire to get as much gold as possible. But the concentration of a growing part of the world's total gold reserves in the United States of America has made this very difficult to accomplish ; for

it has left the rest of the world acutely short of gold. The smaller countries in particular, unable to accumulate sufficient gold reserves of their own, have had to content themselves with building up balances of money in the banks of the leading countries, and with guaranteeing the convertibility of their own currencies, not into gold, but into such foreign money as their nationals may require. This is known as the *gold exchange standard.*

Now, in the past London has been both by far the most important centre for the financing of world trade, and the place in which the availability of gold for export has been most completely assured. Countries working under the gold exchange standard have therefore been disposed to keep a large part of their foreign balances in London, and to use London as the agency through which to provide themselves with the foreign currencies which they have required. The Bank of England has thus been exposed to the strain not only of meeting the demands of English people for foreign money, but also of acting as intermediary in its supply for the nationals of a number of other countries. This has exposed the British banking system to the risk of abnormally large gold movements ; and it is in the circumstances perhaps remarkable that the Bank of England has not sought to possess itself of a larger gold reserve than it has actually kept. To keep as small a reserve as possible is of course good business, for gold itself locked up in the coffers of a bank makes no profit.

But while, according to orthodox standards, the Bank of England has been moderate in its demand for gold, it is questionable whether on a rational view most of the gold which it has possessed has really served any useful purpose. For the Bank of England, like most other Central Banks, is compelled by law to keep a reserve of gold not only in order to meet possible demands for export, but also against its issue of currency for internal circulation. But what is really the use of such a reserve ? The absolute destruction of it or its sinking at the bottom of the sea would make not a ha'porth of difference to the value of the paper money in

circulation, as long as the same amount of paper money continued to be issued without a gold backing as would have been issued if the gold had been there to back it. Bank notes derive their value, not from the amount of gold that the Bank of England keeps in its vaults as a backing for them, but simply from the amount of money circulated through the banking system. The only way in which, if the amount of bank notes remained unaltered, their value could possibly be affected by the disappearance of their gold backing would be through the loss of a sense of security—that is to say, it would depend on the loss of confidence in the paper money that people might feel if its gold backing were withdrawn. But this means that a country keeps a reserve of gold against its internal issue of currency, not because its gold reserve is of any conceivable use, but simply because people think it is.

Gold Reserves Against Currency Useless. Bank reserves of gold held against internal issues of notes are in fact absolutely useless. A banking system needs enough gold to meet possible demands for export ; but it needs no more. This, however, raises another question. What are " possible demands for export " ? Under normal conditions they are quite small in relation to the total volume of currency ; but under abnormal conditions it is impossible to set any limit to their potential amount. It is actually out of the question for any Central Bank (except those of France and America under their present quite exceptional circumstances) to keep a gold reserve adequate to meet all possible demands in case of emergency. If a real run on the Central Banks for gold does occur they are bound to suspend the gold standard. For this reason there seems little point in keeping a gold reserve too large for normal requirements but much too small to meet any really serious emergency. It would be far more sensible, if countries are to remain on the gold standard at all, to be content with much smaller reserves, and to be prepared to suspend the gold standard when an emergency arose. This was what Great Britain

had to do in 1931; and the fact that her gold reserve was £160,000,000 rather than £60,000,000 before the crisis arose, so far from helping her, only caused her to make a futile effort to remain on the gold standard when she would have done far better to go off it some time sooner.

Of course the attitude of the public is not wholly irrational. The necessity of keeping a gold reserve against the issue of currency does have the effect of restricting the total amount of currency that the Central Bank is able to issue. It does prevent inflation in the sense of an over-issue of currency beyond a certain point. People feel that, if the Central Bank were no longer compelled to keep a gold reserve against the internal issue of money, there would be less assurance that inflation would not occur. But this protection is far more apparent than real. The Bank of England for example, is already allowed to issue £260,000,000 worth of notes, and during the present emergency by exception £275,000,000 worth without gold to back them. There is nothing on earth to prevent Parliament from increasing this fiduciary issue to any extent that it likes, and thereby making possible any degree of inflation without altering in any way the obligation on the Bank to hold gold against all notes issued beyond the fiduciary limit. This, of course, could be done only by Act of Parliament; but the point is that, as the present fiduciary limit is also fixed by Act of Parliament, the legal obligation on the Bank to keep a gold reserve against notes issued beyond the fiduciary amount is not even now a protection against inflation. The real protection is simply the unwillingness of the Bank itself and of Parliament to increase the fiduciary issue.

The Gold Standard Before and After the War. Before the war, when gold movements were relatively small and trade followed on the whole well established channels with comparatively small relative changes from year to year, there was no great difficulty in the working of the gold standard; and most countries were in a position to keep some sort of gold reserve against their internal

issues of currency, and also to provide gold for export when it was legitimately required. Even then, indeed, few countries really allowed the absolutely unfettered export of gold ; and it was often said that Great Britain was the only country in the world that was fully and completely on the gold standard. Other countries were often willing to provide foreign exchange—that is, to supply those who needed foreign money with credits abroad rather than with gold for export ; and for this purpose their banks used already to keep balances in foreign centres and especially in London. But no considerable difficulty arose out of this arrangement ; and London, to which the supply of new gold from South Africa was regularly brought for sale, was always able to supply the demand.

When, however, one country after another returned to the gold standard or adopted it for the first time after the war, the situation was very different. The total supply of gold in the world was indeed increasing faster than ever before owing to the rising output of the South African mines, which provide the greater part of the world's new gold. But the amount of new gold mined each year is very small in relation to the stock already in existence ; and a good deal of it is regularly absorbed into non-monetary uses. The great rise in the total level of prices during the years of inflation therefore left the total gold supply of the world much smaller in relation to the money value of the transactions needing to be financed than it had been in pre-war days. This made it indispensable for the world to economise in its use of gold, both by withdrawing gold coins from circulation and substituting paper without complete gold backing and by adopting various devices in order to make their gold reserves go further than before as a basis for currency. These methods were effective in reducing the world's total need for monetary gold within the limits that could have been covered by the available supply if this supply had been distributed in accordance with the special needs of each country. But in fact far too large a proportion of the total gold supply of the world soon began to be

absorbed by two countries—first the United States and at a later stage France as well. The result was that the adequacy of the total supply failed to ensure the smooth working of the gold standard, or to prevent the scarcity of gold in some countries from forcing world prices down. For the countries which had too much gold did not venture to make use of their entire supply as a basis for the issue of currency, for fear of raising their own price levels above the levels of prices in the rest of the world and thereby destroying their export trades and encouraging huge imports even over their high tariff walls. A substantial part of the world's monetary gold thus came to be locked up in France and America without performing any function at all ; for it was neither needed for export nor used as a basis for currency. These accumulations of gold involved the countries which held them in considerable loss ; for the gold lying idle in the vaults of their banks brought in no interest. But the over-supply of gold in France and America produced far more serious reactions on the rest of the world ; for, although other countries did something to economise further in the use of gold in face of the contraction of their supplies, the constant tendency of gold to drift to France and America compelled them, unless they were prepared to come off the gold standard altogether, to adopt a restrictive policy both in the issue of currency and in the volume of credit made available for their industries. This restrictive policy caused their price levels to fall ; and as world prices fell it became more than ever necessary for France and the United States to lock up a part of their gold in idleness in order to prevent their price levels from getting out of equilibrium with those of other countries.

Gold in America. Why then, we must ask, did gold silt up in France and the United States ? The answer is fairly simple, though it is not quite the same in the two cases. The United States, as we have seen, emerged from the war as a great creditor country, to which all the other leading

countries owed considerable sums of money each year not only as payment for imports but also as interest on accumulated debts. These countries, moreover, were buying from the United States, chiefly in raw materials and foodstuffs, far more than the United States with its high tariff was prepared to buy from them in manufactured goods. There was accordingly on current account a double balance in favour of the United States, arising partly from the excess of American exports over imports and partly from the debt payments due from the various countries to the American Government and its citizens. To a certain extent this excess was reduced by the great number of Americans who came as tourists to visit Europe and spent money freely in the debtor countries. Moreover, a large part of American overseas trade is carried in foreign, especially British, ships ; and this also tends to redress the balance. But there still remained a very large balance of payments due to America from the rest of the world.

The only way in which the United States could under these circumstances avoid attracting to herself an undue proportion of the world's gold was for her citizens to invest enough new capital overseas each year to make the account balance. In the years between 1924 and 1928 they were on the whole doing this ; and the supply of gold held by the banks and the Treasury in the United States was actually smaller at the end of 1928 than in 1924. But thereafter it increased rapidly. At first this was due to the American boom, which, as we have seen, caused both a decrease in American overseas lending and an influx of foreign capital into the United States. After 1929 it was due to the American slump, which made American citizens and American bankers too nervous to invest or lend money abroad, and anxious to hoard their resources in the securest and most liquid form. Under these circumstances it was impossible to prevent gold from silting up in America, and in 1930 to 1931 the American gold stock increased very rapidly indeed, and the debtor countries were so denuded of gold reserves as to be driven, one after another, to restrict the free export of

gold, or even in effect to suspend the gold standard altogether.

The French Hoard. The conditions in France were somewhat different. From 1924 to the end of 1927 the French gold stock remained practically unchanged. France was not then back on the gold standard ; and the movement of gold in or out of the country was virtually in suspense. But during the period of inflation French citizens, fearing that their money would lose value if they kept it in the country, deposited as much as they possibly could of their available resources in overseas banks. They were able to do this on a large scale because France was, even at this time, a creditor nation receiving a surplus of income from abroad on account of both of her overseas investments and of the balance due to her for reparations, after meeting such war debt payments as she agreed to make. Thus at the time when France restored the gold standard, with the franc at one-fifth of its pre-war gold value, Frenchmen and the French banks held very large sums deposited abroad. These sums had not been invested at long term, as most of the American overseas lending had been. They were short-term deposits which their owners were free to repatriate whenever they chose.

The stabilisation of the franc and the restoration of the gold standard in France soon caused Frenchmen to begin bringing home again some of the money which they had left on deposit abroad. Between the end of 1927 and the end of 1929 the French gold reserve more than doubled. This process of gold accumulation in France has continued through the subsequent years, but at a greatly varying rate. Whenever the French have either taken alarm at the signs of instability in foreign banking systems, or have had one of their periodical fits of acute political mistrust, there has been a rush to repatriate balances ; and gold has flowed in extraordinary amounts into the coffers of the Bank of France. This has been the more serious because the French are at any time far more

reluctant than the Americans to make long-term loans overseas and thus lock up their money. They are indeed prepared at most times to make large short-term deposits abroad in order to get some interest on their money instead of leaving it lying idle in the vaults of their banks , but this money which they deposit abroad on short term is always liable to sudden recall, and therefore it is an embarrassment rather than a help to the countries in which it is deposited. The sudden cessation of American lending to Europe in 1929 was perhaps the greatest cause of the European crisis ; but the constant ebb and flow of French foreign deposits sets up a perpetual insecurity in the European financial system, and is therefore hardly less serious.

The gold standard under these circumstances has not only worked very much worse than it used to work before the War, but has proved during the present world depression absolutely unworkable for the debtor countries and even for Great Britain. The debtor countries have been denuded of their gold in an attempt to keep up debt payments and to buy imports in face of the great fall in the value of the commodities which they export. Great Britain, as the centre primarily concerned with financing the short-term money requirements of a great part of the world's trade, has felt the repercussions this strain experienced by the debtor countries very seriously indeed ; and, though she is herself on balance a creditor and not a debtor, it has been impossible for even the British system to maintain the free export of gold. For a long time before the crisis of 1931 caused her at length to suspend the gold standard the attempt to remain upon it had involved a restrictive currency and credit policy which had seriously hampered the working of British industry.

The Flight From The Gold Standard. A large part of the world has thus been driven off the gold standard, which had been so painfully restored during the decade following the end of the war. This has happened in most countries directly because they have run so short of gold as to be

unable to permit it to be exported freely, but more fundamentally because the balance of payments due from country to country has been completely upset. The gold standard can be made to work only if the amounts of gold actually needing to be transferred in settlement of balances due from one country to another are quite small. As soon as there arise large debts which cannot be settled by the transfer of current goods and services, the gold standard is bound to break down. It is therefore plain enough that there is no prospect of the world going back to gold unless the payments due from country to country in respect of current goods and services and of debt obligations can again be made to balance. This means that either there must be a balance in the movement of actual goods from country to country, making allowances of course for "three-cornered trade" and for such invisible items as shipping services and tourist traffic, and that the debtor countries must be allowed to export to their creditors more than they import from them; or in the alternative, that the creditor countries must steadily and continuously invest abroad the surplus due to them. But as this process of investing abroad results in a steady accumulation of additional debts it necessarily makes the keeping up of the balance every year a more difficult problem. It means in effect that the creditor countries can only go on being paid—unless they are prepared to take payment in the goods and services of the debtors—by constantly re-lending the money on an ever expanding scale; or, in other words, by not being really paid at all.

It is therefore safe to predict that the world, if it ever goes back to the gold standard, will not be able to do so without a readjustment both of the existing burdens of international debt and of the tariff barriers of the creditor countries. But in the meantime what is the position of those countries which experience at present no difficulty in remaining upon the gold standard because they are both creditors of the rest of the world and already in possession of an enormous supply of gold?

These countries—France and the United States—are

already in very considerable difficulty. They have plenty of gold ; but if they use it as a basis for currency the effect will be to raise their price levels. They can indeed do this more easily now than they could while the rest of the world was on the gold standard ; for the departure of Great Britain and other countries from that standard has to some extent released their currency and credit policy from dependence on their dwindling gold stocks. This is the real meaning of the recent movement towards credit expansion, now nick-named "reflation," in the United States—a deliberate attempt to expand the supply of credit in such a way as to raise prices and thus to encourage a revival of American industry. But the Americans and the French are still in a very serious difficulty ; for the depreciation in the gold value of the currencies of those countries which have been driven off the gold standard has cheapened their exports in the markets of the world in relation to the exports of the countries which are still charging prices reckoned in gold. The exports of the countries whose currencies have become depreciated have thus received a stimulus ; and at the same time they have become worse markets for the gold standard countries to sell in. For in order to get a given sum in dollars or francs the American or French exporter must charge more pounds sterling or Swedish crowns for his goods. America and France, if they remain on the gold standard, are therefore threatened with the loss of a considerable part of their export trade, while it becomes easier for the countries which have abandoned gold to export to them ; for the British exporter has only to charge less dollars in order to get a given sum in pounds sterling. The Americans and French can indeed, by raising their tariffs, check the tendency of their imports to increase ; but they cannot, save by selling at a loss, expand their exports to the countries which have gone off gold. They have actually raised their tariffs and thus discouraged imports ; but this has not saved them from a great increase in unemployment as a result of the high valuation placed upon their currencies by their remaining on gold.

Creditor and Debtor Countries. If America and France took no steps to raise tariffs, the effect of their remaining upon the gold standard would doubtless be, in the end, to destroy their position as creditor countries by so restricting their exports and expanding their imports as to annul the balance of payments at present due to them on international account. But neither America nor France is prepared to take this course, which would involve a steadily growing competition of foreign manufactures in their own home markets. They therefore attempt to meet the situation by curtailing their imports as their exports decrease. This preserves their position as creditors, with all its disadvantages for the rest of the world ; but it cannot help them to restore their exporting industries.

Indeed the depreciation of other currencies in relation to dollars and francs has made the burden of the debts due to the gold standard countries weigh far more heavily upon the debtors, who have now to supply larger amounts of their own currencies in order to pay a given debt to France or the United States. This increase of debt burdens has already led to serious defaults in South America, as well as to the necessity of declaring a moratorium in Europe. The position of the countries which have an abundant supply of gold, and are therefore technically able to remain on the gold standard for as long as they like, is therefore by no means as sound as it appears ; for while they have no difficulty in keeping their currencies at par with gold the reaction upon their manufacturing industries is bound to be disastrous. They must lose a large part of their exports, and their attempts to restrict imports by higher and higher tariffs are bound in the end to involve default by the debtor countries.

It is therefore clear that, on the one hand, the countries which have gone off the gold standard cannot possibly return to it until world debts and world tariffs have alike been drastically reduced, and on the other that the countries which remain upon the gold standard can only remain upon it at a large and growing sacrifice of internal welfare.

This being so, the nations of the world will evidently have sooner or later to come together and either reach a basis of accommodation in respect of both debts and tariffs that will again make the gold standard workable, or, in the alternative, devise some new standard in place of gold. All the manoeuvrings of the past two or three years have been based on the attempts of the various nations to get round their more pressing difficulties without really facing up to this fundamental necessity. But sooner or later it will have to be faced, or the world economic system will go down to utter catastrophe, and will have to be rebuilt anew from the very foundations after an interval of chaos.

Shall We Go Back To Gold ? Even if the world does decide in the end to go back to gold because of its convenience as a standard for international payments it does not, of course, follow that the gold standard will be restored in anything like its previous form. In the first place those countries which have gone off gold are most unlikely ever to attempt to bring back their money to its previous gold value. If, for example, Great Britain ever resumes gold payments, the pound sterling is most unlikely to be restored to its previous gold parity. There will almost certainly be some devaluation, though it is impossible to say at present how much devaluation will be required. Great Britain will not, like France, have to wipe off four-fifths of the old gold value of the franc, or like Germany, to adopt a new currency unit altogether ; but she is likely to have to devaluate the pound by anything between the extreme limits of say 15 and 30 %.

This is because, when Great Britain returned to the gold standard in 1925, the pound sterling was undoubtedly over-valued in relation to its internal purchasing power. By putting at that time too high a gold value on the pound, the British Government and the Bank of England hampered the British exporter by making his goods too dear in terms of foreign currencies. This was one of the chief causes of the widespread unemployment in Great Britain during the

years before the world slump ; for the British exporter could only have counteracted the too high gold value of the pound if he had been able to cut down his costs of production very drastically indeed. He could not have done this without very large cuts in both wages and interest payments ; but in fact interest remained high, partly owing to the restrictive banking policy traceable to the shortage of gold, and the wage-earners put up a stiff resistance to wage reductions which, in order to be effective, would have needed to go far beyond any actual or anticipated fall in the cost of living.

If, then, the world goes back to gold, it will almost certainly be on the basis of a relative valuation of national currencies different from that which existed before the world crisis. There will be devaluation, and not merely as at present depreciation, of the currencies of the countries which have been driven off gold. But it is not to be taken for granted that the world will go back to the gold standard in the old sense, even if it continues to use gold to some extent as a means of settling international balances of payment. The old gold standard involved giving each national currency a permanently fixed value in relation to the rest ; for each country fixed a definite gold equivalent for a unit of its national money, and the assumption was that these equivalents would remain permanently unchanged. There is, however, no reason in the nature of things why this should be so. It would be quite possible for a country, while maintaining its willingness to give gold in exchange for its currency on demand, to reserve the power of varying from time to time the amount of gold thus treated as equivalent to a unit of national money—the pound sterling for example. The power to get gold in order to settle debts abroad in case of need would thus remain in being ; but the relative values of different currencies would no longer be definitely fixed within the narrow limits of the gold points.

But, it may be urged, surely the whole value of the gold standard lay in the fact that it did ensure a stable relative

value for different national currencies ; and there would be no point in preserving it at all if it ceased to achieve this result. This view rests on a misunderstanding. There are indeed great inconveniences for trade in a constant fluctuation from day to day in the relative values of different national moneys. But there is no reason why the gold value of each currency should not be kept stable over fairly long periods, and yet the power be reserved to make changes rarely and in response to proved necessities based on long-term tendencies. Under this system the foreign exchanges would be kept pegged, under normal conditions, within the limits set by the gold points ; but, if a long-term disequilibrium arose in the price levels of different countries or in their mutual balances of payments, this could be corrected by a change in the gold values of the currency of any such countries. This system would give the trader and the banker a sufficient degree of stability to enable them to carry through the ordinary operations of financing international trade without fears based on possible short-term changes in the relative values of different currencies ; but it would at the same time provide means of removing the necessity for giving up the gold standard if long-term forces caused a particular country to be drained of gold, or seriously upset its balance of payments. It seems likely that if the gold standard is restored at all, it will be subject to some such safeguard as this, and no longer based on an absolute fixity in the gold value of the currencies of the leading nations.

Alternative Currency Standards. There are, however, many people who would greatly prefer to get rid of the gold standard altogether, and to adopt some other standard in its place. There are among these reformers two schools of thought—those who think of the problem purely on national lines, and those who consider it also in its international aspects. Reformers of the second school recognise the need for a stable international standard which will preserve, at any rate over short periods, the

fixity of the relative values of different national moneys. They have mostly advocated in place of gold what is called a " tabular standard "—that is to say, a currency standard based not on gold or on any other metal but on some sort of index number of commodity prices. There are, however, quite extraordinary difficulties in the way of the international adoption of any such tabular standard. It is difficult enough, as we saw in the last section (see p. 180 ff.) to measure adequately an internal price level even of a single country, for the existing indices of wholesale prices by no means adequately reflect the movements of all the prices that have to be taken into account in considering the adequacy or inadequacy of the national monetary supply. There is in fact no such thing as *the* national price level—at all events in a sense in which it can be accurately measured as a whole. Still less, then, is it possible to measure the international level of prices, or to devise a currency standard based upon its measurement. For, while a small number of commodities which are easily transferable and enter widely into trade all over the world—wheat is the outstanding example—can be said to have international prices current over the world as a whole, this does not apply to the great majority of commodities, nor have the prices of these internationally traded goods any fixed relation to the varying national prices of other commodities and services.

The hope of an international currency standard based on the level of world prices is therefore illusory, at any rate at the present stage of the world's statistical knowledge and equipment. Indeed, I think it is out of the question permanently. But this does not dispose of the currency reformers who want each country to base its own currency on its price level, and prefer a national stability of prices secured by this means to any fixing of the relative values of different national moneys such as the gold standard seeks to secure. There are in fact two kinds of stability which it is possible for a country to pursue in its currency policy. It can aim at stabilising either its internal price level or the external value of its money ; but it cannot possibly, at any

rate at the present stage of world organisation, stabilise both. If it fixes its internal price level, the value of its currency in terms of foreign currencies is bound to vary. If it fixes the gold value of its money, the level of its internal prices is bound to change. It is impossible for the currency reformer to have it both ways.

If, however, it were agreed that the aim of national monetary policy should be to ensure as far as possible the stability of internal prices it might still be practicable to limit the fluctuation of the foreign exchanges to deliberate alterations made in the value of the national money in response to long-term forces. If this could be done, the desire to secure price stability at home could be reconciled with the needs of traders and bankers for short-term stability in the rates of exchange.

But the pursuit of stability in the domestic price level is not consistent with continuing to use gold as a basis for the internal issue of currency. It may be quite possible to continue the use of gold as a means of settling international balances (provided these are of reasonable amount) ; but it would be necessary at the same time to give up definitely the holding of any gold reserve against the internal currency issue, or the regulation of this issue in accordance with changes in the available gold stock. There is nothing inconsistent in keeping gold as a means of settling international balances, while abandoning its use as an automatic regulator of the supply of domestic currency. There is a strong case for continuing to use gold for the first purpose ; but there is none at all, except men's fear of inflation, for using it for the second.

It does not, however, follow, because we should give up regulating the internal issue of currency in accordance with the available supply of gold, that we should be wise to adopt any other automatic standard in place of gold. There are, as we have seen, grave objections to any attempt to regulate the supply of currency automatically in terms of the price level ; for even within a single country no one can really say what the price level of *all goods and services* is.

The accessible information about price movements, including not only the familiar indices of wholesale and retail prices but also such data as can be secured concerning the prices of labour, houses, stocks and shares and all other things that need to be bought and sold, is indeed of the very greatest importance in guiding those responsible for monetary policy in making up their minds how much money the community requires. But it is not possible to add up all these various fragments of information so as to make out of them a single comprehensive index suitable as a basis for automatic currency regulation. The responsible authority—whether it be the Central Bank or any other agency—will have to use its judgement in deciding what weight to give to the various price tendencies which it will be able to bring under review. In other words the future regulation of the currency will have to be based, not on a automatic response of the regulating authority either to the movement of gold or to a standardised price index, but on deliberate *management*. There will have to be in each country a *managed currency*, so administered as to secure that the supply of money is contracted and expanded in accordance with changing needs, and the level of prices kept not absolutely stable but stable enough to give the manufacturer and the consumer reasonable security, and to eliminate those price fluctuations which are due not to real changes in the cost of production but to purely monetary causes. How far it is in fact desirable to keep national price levels stable has been discussed in the last section. At this stage I am only concerned to suggest that it is quite possible both to secure as much stability as we are likely to want in the internal level of prices and to use gold as a means of settling international balances, provided first that these balances are not too large, and secondly that we do not at the same time attempt to use gold as a basis for the internal issue of currency.

With these considerations in mind we can now turn to a brief survey of the actual structure of those banking institutions to which, in the modern world, the regulation of

currency and credit is chiefly entrusted. Out of many possible examples let us take two—the most important for the world's monetary system as a whole. Our first example will be the Bank of England with its place at the traditional centre of international finance, and the joint stock banks which in association with it are the chief distributors of internal credit to British industry. Our second example will be the Federal Reserve System of the United States, which has served as a model together with the Bank of England for the reconstruction of Central Banking methods in most countries since the war.

§4. THE BRITISH BANKING SYSTEM

THE CENTRAL Bank of Great Britain is the Bank of England—an old-established private corporation first set up in 1694. The Bank of England obtained its original charter in return for a loan to the Government of the day, and its privilege of issuing bank notes was first accorded to it in connection with this loan ; for it was allowed to issue notes against the money lent to the Government without gold backing. At first the privileged position of the bank encountered much opposition, and its charter was more than once in jeopardy ; but throughout the eighteenth century it gradually consolidated its position ; and the financial necessities of the State during the Napoleonic Wars finally established it as the Central Bank of the country, although its position as the regulator of the currency was not finally laid down until the Bank Charter Act of 1844. Throughout its career the powers of the Bank of England have been regulated by Act of Parliament under its successive charters ; but apart from this regulation it has remained a purely private body, owned by a number of shareholders, to whom it pays dividends on their invested capital, and administered by a court of Governors appointed by the shareholders without any control over the

appointment by the State. In being a private institution owned by a body of shareholders the Bank of England resembles most other Central Banks, except that of the United States. But a good many of the others are unlike it in that, although they are privately owned, the Government of the country appoints some or all of their directors. Thus the Governor and Deputy-Governor of the Bank of France are appointed by the Government ; and all the Directors of the Reichsbank were similarly appointed until it was reconstructed at the dictation of the Allies under the Dawes Plan of 1924.

But although the Bank of England is in form wholly independent of any sort of Government control, apart from the regulations laid down for it by Act of Parliament, in practice the relations between it and the Treasury are very close indeed. The Chancellor of the Exchequer and his officials at the Treasury are in constant consultation with the Governor and other officials at the Bank ; and it is often hard to say whether the Treasury has more control over the Bank than the Bank has over the Treasury in the formulation of financial policy. Practically always the two work in together, and a divergence of policy between them is in modern times almost unknown.

This close association between the Government and the Bank depends partly on the fact that the Bank acts regularly as the Government's agent in many vital financial matters. The Government and its various departments keep their accounts at the Bank of England ; and whenever the Government wants to borrow money it entrusts the Bank with the carrying through of the necessary operations. Often, too, the Government borrows from the Bank itself, or leaves it to the Bank to decide whether it is preferable to do this or to borrow from the market by way of short term Treasury Bills. Any such operation as the conversion of part of the public debt would be undertaken through the Bank and in close consultation with it. The Bank of England is thus in the closest every-day touch with the affairs of the Treasury and always in a position to know what policy

the Treasury wishes it to pursue, and to bring pressure to bear upon the Government to cause it to follow any policy which the directors of the Bank may think expedient.

In addition to serving as the Government's banker, the Bank of England also keeps the accounts of the other banks, including both the great joint stock banks primarily responsible for the conduct of deposit banking and most of the specialised financial houses which form an important part of the financial mechanism of the City of London. We have seen already how the joint stock banks keep balances lying at the Bank of England, and treat these balances as the equivalent of actual cash in assessing the amount of credit which they are in a position to create. Debts due from one bank to another are settled by book-keeping entries at the Bank of England—that is, by a transfer of sums from the account of one bank to another. The Bank of England thus has its hand continually on the pulse of the entire banking system, including not only the joint stock banks but also the London city houses and the numerous foreign financial institutions which maintain offices and do business in London.

Thirdly, as we have seen, the Bank of England is the body entrusted by Parliament with the regulation of the currency under the conditions laid down in the Act of 1928, by which the Treasury notes issued directly by the Government during the war were transferred to the Bank of England and the entire management of the currency system thus placed in its hands. The joint exercise of these three powers gives the Bank very great authority in co-ordinating and controlling the policy of the whole British financial machine. If it lacked any one of the three it could not perform the others with anything like the same strength and efficiency.

Unlike the Central Banks of some of the other leading countries—Germany and France for example—the Bank of England does not maintain a far-flung system of branches throughout the country, or attempt to any appreciable

extent to do business with the general public. Ordinary private citizens and business firms keep their accounts not in the Bank of England but in one of the joint stock banks ; and the business of bill discounting is usually undertaken not directly by the Bank but either by a joint stock bank or by one of the specialised discount houses. The Bank of England does not diffuse its activities. It aims at concentrating as far as possible on its three functions of regulating the currency and acting as the banker of the Government and the other banks and leading financial institutions of the City. It is thus not a competitor of the joint stock banks or of the City houses, and it is free to pursue a policy dictated by its three main functions without considering such complications as might arise if it were also concerned with general banking business. It is in accordance with this policy that it pays no interest on the sums deposited with it, and makes no effort to attract deposits from the business world. Nor is it in fact an institution worked with the object of securing the maximum profit for its shareholders ; for it has paid for many years a stabilised dividend which it is easily able to earn, and any profits made over and above the amount required for payment of this dividend are placed to reserve so as to strengthen its position for the future. Its shareholders, who are primarily the big City houses and financiers of the City of London, readily acquiesce in this policy ; for they want the Bank to be run, not so as to make the largest possible profits for itself, but so as to further the most profitable working of the financial machine as a whole. The Bank is run not in the interests of its shareholders as such, but essentially in those of the London financial world. It does not, of course, follow that it is run either in the interests of industrialists as distinct from financiers or of the community as a whole. That is a point which we shall have to consider at a later stage.

Bank Rate. The most familiar instrument of Bank of England policy is what is known as Bank Rate. Every week the Directors of the Bank announce what Bank Rate is to be

and this announcement usually exercises a decisive influence on monetary conditions throughout the country, because the other banks usually adjust the rates at which they are prepared to make loans to the rate announced by the Bank of England. The Bank of England Rate, however, is important far more in the influence which it exerts on rates of interest generally than for its own sake. It is in itself only the rate at which the Bank of England is prepared to rediscount trade bills of exchange bearing at least two good London names. But trade bills are not habitually discounted or rediscounted at the Bank of England at all ; and Bank Rate is normally well above the rate at which the joint stock banks and discount houses and bill brokers are prepared to discount bills. The normal business of discounting bills is performed by these other agencies without recourse to the Bank of England ; and only in exceptional circumstances does it become necessary for them to rediscount their bills at the Bank. This happens only when the joint stock banks and the foreign banking institutions in London, which are the normal suppliers of the funds used for discounting bills, decide to contract their liabilities by restricting credit. The bill brokers and discount houses, who have borrowed money from the joint stock and other banks and used this money for discounting bills, are driven, when such a contraction of credit takes place, to the Bank of England for accommodation ; and one of the most important services which the Bank of England performs is that it is always prepared to rediscount any eligible bill at the current Bank Rate. There is thus always a lending agency on which the City of London can fall back in the last resort when money is tight ; but the rate charged by the Bank of England is always high in relation to current rates, and usually, when the brokers and discount houses are compelled to borrow from the Bank of England, this involves them in a loss in that they are forced to rediscount the bills which they hold at a stiffer rate than they accepted when they originally discounted the bills. Rediscounting at the Bank of England is thus the last resort of the bill broker

and the discount house ; and the existence of any considerable amount of rediscounting at the Bank is always a sign of monetary stringency.

Bank rate would, however, exert a decisive effect on monetary conditions even if no single person rediscounted a bill at the Bank of England ; for the rate announced by the Bank usually produces an immediate effect on all the rates of interest charged in London for the loan of money for a short term. It affects, for example, the rates of interest charged by the joint stock banks for ordinary overdrafts to their customers—that is to say, for industrial borrowing in the widest sense ; and it also affects the rates fixed by bill brokers and discount houses for discounting trade bills—that is to say, the rates at which money can be borrowed for use in foreign trade. For in Great Britain foreign trade is financed mainly by means of bills of exchange and not of bank overdrafts ; and the City of London also plays an important part in the financing by this method of trade between foreign countries. Internal trade, however, is in Great Britain financed hardly at all by means of bills, whereas in France a large part of internal trade continues to be financed in this way, and the cheque system and the ordinary banker's overdraft are far less in use. This, however, does not affect the influence exerted by the Bank of England over short-term interest rates of all sorts, for Bank Rate influences the rates charged alike for banker's overdrafts and for the discounting of bills.

Other Money Rates. This does not mean that an alteration in Bank Rate will always cause a directly proportional change in the rates charged by bankers or City houses. Joint stock banks, for example, while they vary the rates of interest charged on overdrafts with every upward movement of Bank Rate, usually maintain a minimum below which they will not reduce their rates of interest however low Bank Rate may fall. It is often stated that the minimum rate at which the joint stock banks are prepared to lend is 5%. This is not strictly true—for they do make exceptions—

but it is true that they will not under any circumstances reduce their normal rates to ordinary borrowers below 5%. As Bank Rate rises they increase their rates, always keeping well ahead of it; for, whereas Bank Rate is always higher than the current market rates for the discount of bills of exchange and the borrowing of day to day money, it is always lower than the rates charged for ordinary industrial overdrafts. This difference exists because money lent to industry is always lent for a longer period, usually six months, whereas the discount houses and bill brokers borrow money at call—that is to say, on a promise to pay it back at any time if the bank wants it. The banks are willing to lend at cheaper rates on these terms because this enables them to keep a substantial part of their resources in a very liquid form. If the joint stock banks wish to contract their liabilities by reducing the amount of their loans, they can do this very quickly indeed by calling in some of the money which they have lent to the discount market; but it takes them considerably longer to reduce the volume of their industrial overdrafts.

But why, it may be asked, are ordinary business men prepared to pay higher rates of interest on their borrowings than are charged to the discount market? The answer of course is that mere day to day borrowings would not suit their purpose; for the business man who borrows money for the purpose of financing a productive or trading operation needs the money for a long enough period to enable him to carry through the production or sale of the goods and get paid for them before he is compelled to repay his borrowings. He cannot face the risk of borrowing at call and having the money demanded back before the turnover is completed. He is therefore willing to pay at a higher rate for accommodation guaranteed for a period of six months, or exceptionally for longer still; and the joint stock banks for their part charge more because money lent in this way has to be locked up for six months or more, and is thus less liquid than loans made for a shorter period. The British banker has always aimed above all else at keeping a

large part of his resources in the most liquid possible form.

This desire for liquidity reacts to some extent on the willingness of the banks to make advances which will really meet the needs of the producer. For a considerable amount of production or trade involves a longer period of turnover than the six months for which ordinary bank loans are made. Loans to agriculture for example have usually to be made for a longer period; and there have been many complaints of the inadequacy of the facilities available in Great Britain for the farming community. Moreover, many important industrial contracts involve leaving money outstanding for considerably longer than six months; and the ability of a producer to take on a large order or to give extended credit to his customers may often depend on his ability to get extended credit for himself. In practice, accordingly, the banks often do make loans for much longer periods than six months; but they usually insist in form on the loans being on a six-monthly basis and then grant renewals in case of need. In recent years a considerable amount of the money lent by the banks to industry has in fact got locked up, not merely for six months but for years on end, wherever the long continuance of trade depression has put business firms into difficulties. A substantial part of the advances made by the banks to the heavy industries and to the textile trades has become "frozen" and could only be recalled by the banks at the cost of driving the borrowers into bankruptcy. But this mass of "frozen" credits has arisen not because the banks intentionally made loans for years on end, but because it has been in practice impossible to recall loans originally made on a short-term basis.

Credit and Capital. In Great Britain the banker is accustomed to draw a sharp line between those kinds of business borrowing which can legitimately be financed by means of bank overdrafts and those which cannot. It is none of his affair, he will tell the business world, to provide long-term capital for industry. That is a matter for the capital market; and long term-capital ought to be provided

out of savings and not by means of bank credits. His affair is simply to grant short-term accommodation ; and it is outside the function of a bank to step beyond this line. But in practice the distinction is not always easy to draw, and the bankers themselves were very far from drawing it accurately or correctly during the boom period which immediately followed the end of the war. At that time they made to many businesses large advances of money which were used either in buying plant or other forms of business equipment or in acquiring the assets of existing businesses and amalgamating them with the businesses which borrowed the money. These loans were made in the expectation that it would be possible in the near future to issue shares or debentures to the public, and so replace the bank money by capital invested at long term. But when the slump came, taking the business world largely by surprise, it became impossible to appeal to the public with success for the required capital, because the assets of the borrowing business had undergone a rapid depreciation in value. In these circumstances the banks were unable to recover the sums which they had lent ; and this departure from orthodox banking practice thus became a cause of a large addition to the amount of " frozen " credit. " Frozen " credit of this second kind was thus definitely the result of the banks' departure from their normal practice.

In some other countries, indeed, notably in Germany, banking practice differs in this respect greatly from that of Great Britain. For the German banks do normally take large shares in industrial undertakings, and thus convert a substantial part of their assets from a liquid into a temporarily " frozen " form. Even in Germany the banks usually do this, not with the idea of holding permanently the shares which they buy, but with the full intention of selling them to the public at a later stage when their worth has been proved. This difference between British and German banking practice has existed largely because of the greater difficulty experienced by German industrialists in raising long-term capital. Germany has been neither so rich

nor so well-equipped as Great Britain with financial institutions which specialise in acting as intermediaries in the raising of long-term capital ; and the banks have accordingly attempted to fill the gap in the German financial structure. But banks which act in this way, and thus lock up a substantial part of their funds over a considerable period, need more capital of their own than banks which keep their advances as far as possible in a liquid form. It will be found that in general German and other continental banks have a considerably larger capital of their own in relation to the volume of their transactions than British banks, which operate mainly with their depositors' money. This difference in the relative size of working capital and total obligations is closely connected with the differences between British and continental banking methods.

Call Money. Bank Rate, we have seen, influences the rates charged by the banks for ordinary industrial overdrafts ; and it also influences, though not in the same way, the rates charged for call money in the City of London. The joint stock banks are also the main sources of this call money, which is used primarily for the financing of foreign trade by means of bills, but also for speculation on the stock and produce exchanges. The joint stock banks, and also the foreign banks situated in London, have at any time a certain amount of money which they are willing to lend at call, but not to lock up in the form of six months' overdrafts. This money is thus available at a relatively low rate of interest for anyone who is prepared to take the risk of borrowing it on these terms. It is actually borrowed, as we have seen, mainly by the bill brokers and discount houses—we will come to stock speculation in a minute—but the broker or discount house that borrows money at call from the banks uses it to buy trade bills which have a period of time to run—say anything up to three months in the normal case. The borrower thus uses money which he may have to repay at any moment in order to buy something for which he will not get paid for some time. In doing this he

obviously takes a risk, for which of course he makes allowances in the rate of discount which he offers when he buys the bill. He would not be able to take this risk unless, in the event of the recall of the borrowed money, there existed some other agency prepared to give him accommodation. He may, of course, when one bank recalls a loan which it has made him, be able to replace the money by a loan from some other bank. But generally any tendency toward contraction of lending operates upon all or most of the banks at the same time : so that this method of replacement is commonly not open. Under these circumstances, as we have seen, the bill broker or discount house is driven to the Bank of England for accommodation.

The other main group of borrowers of money at call or on very short notice from the joint stock banks and foreign banking institutions consists of the professional speculators on the stock and produce exchanges. These, too, incur a substantial risk when they borrow at short term ; and in their case recourse to the Bank of England is not open when the joint stock banks call in their loans. For the Bank of England will not make advances to speculators against securities. If, therefore, the banks contract credits which they have granted to operators on the stock and produce markets, these operators have to realise even at a loss ; and bank policy can thus exercise a decisive influence on the prices of stocks and primary commodities. If the banks lend freely for speculative purposes in times of boom, prices may be forced upwards out of all reason, whereas a contraction of bank credit at once causes a great mass of securities to be flung on the market, and thus brings about a sensational collapse of stock values when business depression coincides with a restrictive credit policy. It may be said that the banks ought obviously to regulate their advances to speculators in such a way as to prevent or mitigate both booms and slumps in the stock and produce markets ; but in practice it is not easy for them to prevent money granted nominally for other purposes from being actually applied to speculation in times of boom,

while, if a slump occurs, the value of the securities which the speculators have deposited with the banks as cover for their borrowings rapidly falls, and the banks in order to secure themselves against loss are impelled rapidly to call in a part of their loans. It is of the greatest importance to find means of so organising the banking system as to check the speculative excesses of booms and slumps; but it cannot be pretended that this is at all an easy matter. The United States, for reasons to which we shall come later, has found it very difficult indeed.

Deposit Banking. Obviously the primary purpose of the banking system is to provide, first of all, a safe place for the deposit by private individuals and firms of their cash balances and an easy means of transferring money from one person or firm to another. This is essentially the business of deposit banking in its simplest form; and its development in the modern world has been based mainly on the growth of the cheque system, which has greatly facilitated the transfer of money by means of book-keeping entries and resulted in a great economy in the use of actual currency. Secondly, the function of the banking system is the supply of an adequate amount of credit to keep business activity as nearly as possible at a height which will secure the full employment of all the available productive resources, while avoiding any excessive creation of credit likely to result in the raising of prices beyond the point necessary to ensure this full employment.

About the services which the banking system performs in keeping the accounts of individuals and business firms and facilitating their transfer from one to another there is practically no controversy. Everybody agrees that the work is useful and on the whole competently done. It has indeed often been suggested that the cheque-using habit is capable of much greater extension than has been achieved even in Great Britain—for example, that wages should be paid by cheque and not by currency. But it is doubtful whether there would really be any economy in doing this; for the

wage-earner pays out most of what he earns in quite small sums, and the amount of book-keeping which would be involved if he took to paying his own expenses by way of cheque would probably be too great, while there would be no advantage if the wage-earner merely received his wages by way of cheque and then promptly turned the cheque into currency at the bank. If, indeed, the wage-earners' standard of life rose substantially higher the situation might alter ; and it is not possible to put any limits to the potential extension of the cheque system in the future. But the case for its immediate use as a means of paying wages has certainly not been made out as far as Great Britain is concerned.

Bankers and Credit. The main controversy about the working of the banking system arises out of its second function—the creation of credit. For everyone who is refused a loan or overdraft by a bank is apt to feel that this is a sign that the supply of credit is insufficient ; and everyone is also disposed to feel, even when he does get credit, that the interest charged for it is too much. Most schools of financial reformers, it will be found on analysis, are intent chiefly either on cheapening or on increasing the supply of credit made available by the banks. These two things are indeed to a great extent the same ; for a cheapening of credit immediately attracts more borrowers if other conditions remain the same, while if credit becomes dearer a certain number of potential borrowers do not think it worth while to borrow. When, therefore, the banks wish to make credit more plentiful or scarcer they do this mainly, not by lending to people to whom they would otherwise have refused to lend or refusing to lend to people to whom they would otherwise have lent, but by varying the rates of interest. A rise or fall in the rate of interest in itself produces a restriction or expansion in the volume of credit. But the banks do also discriminate in their lending, refusing advances to one man and granting them to another, or refusing to lend more than a certain amount to a

particular customer in accordance with their view both of his own financial solvency and of the probable profitableness of the use to which he proposes to put the borrowed money. Even if the rate of interest remains unchanged the banks can affect the volume of credit by taking stricter or more liberal views concerning the amount of security which they require against overdrafts, or by subjecting the purposes for which the borrowed money is required to a more or less rigid scrutiny. The rate of interest is the most obvious factor governing the volume of credit ; but it is by no means the only factor.

The rate of interest charged by the joint stock banks to ordinary borrowers depends, as we have seen, on the Bank Rate laid down by the Bank of England, subject to the minimum enforced by the joint stock banks themselves. The Bank of England is thus in a position, by moving Bank Rate up or down, to bring about a contraction or expansion in the total volume of credit actually lent by the joint stock banks ; and the Bank usually raises Bank Rate when it considers that credit ought to be contracted or lowers it when it thinks expansion desirable. But the power of the Bank to do this is by no means absolute, for if it fixes a rate which is out of relation to what borrowers are prepared to pay or lenders to accept, then this rate will become ineffective, and the market will break away and proceed to arrange loans on terms which it thinks suitable irrespective of the wishes of the Bank. The Bank is therefore usually careful to keep its rates within the limits of what it thinks the market will accept as reasonable.

Open Market Policy. The Bank, however, has at its command other instruments besides Bank Rate for influencing the volume of credit. The most familiar of these other instruments is the purchase or sale of securities —what is known as " open market policy." The Bank of England at any time holds a large volume of readily marketable securities, chiefly Government debt. Whenever it sells a security someone who buys it has to make payment

for it to the Bank. This will usually be done by means of a cheque drawn on one of the joint stock banks or some similar institution. The effect will therefore be to reduce by so much the sum standing to the credit of the joint stock bank at the Bank of England ; but, as we have seen, this sum is regarded by the bank in question as the equivalent of cash and the foundation of its ability to lend. As fast therefore as the sums standing to the credit of the joint stock banks at the Bank of England are reduced their ability to lend falls. The sale of securities by the Bank of England is thus a powerful weapon for the contraction of the amount of credit issued by the joint stock banks.

On the other hand, whenever the Bank of England purchases a security in the open market, it has to make payment for it ; and this leads in precisely the opposite way to an increase in the sums standing to the credit of the other banks, and thus to an increase in their ability to lend. Open market operations by the buying and selling of securities are used by the Bank of England (and in a similar way by other Central Banks) as a powerful auxiliary to Bank Rate in the regulation of the volume of business credit. The Bank of England can, moreover, use its position as the Government's banker with considerable effect so as to make money plentiful or scarce. For it can, if it wants to take money off the market, persuade the Government to increase temporarily the amount of its short-term borrowing by way of Treasury Bills, or, if it wants to release money, cause a number of Treasury Bills to be paid off. This policy, however, is only effective as a purely temporary measure ; for Treasury Bills can be used on occasion as cash or treated as the equivalent of cash for the purpose of bank advances.

The main instruments of the Bank of England in regulating credit are thus Bank Rate and open market policy ; and it is hardly too much to say that joint use of these two gives the Bank under normal conditions practically complete control over the plenty or scarcity of credit in the economic system as a whole. The joint stock banks have

relatively little control over the total volume of the credit which they are in a position to create, although they have great power in determining the distribution of these credits between different borrowers. This is not because the Bank of England has any compulsory powers over the lending policy of the other banks, or because these other banks are subjected to any kind of legal regulation of the volume of their loans. Legally and technically they are perfectly free to lend as much or as little as they like, and to take no account of what the Bank of England wishes them to do. But in practice they do follow the policy laid down by the Bank of England for them with considerable closeness, and any attempt by them seriously to depart from it would not find the Bank of England by any means defenceless. For, as we have seen, the Bank of England can at any time, by persisting in its open market policy, contract or expand to almost any degree that is likely to be necessary the cash reserves at the disposal of the joint stock banks.

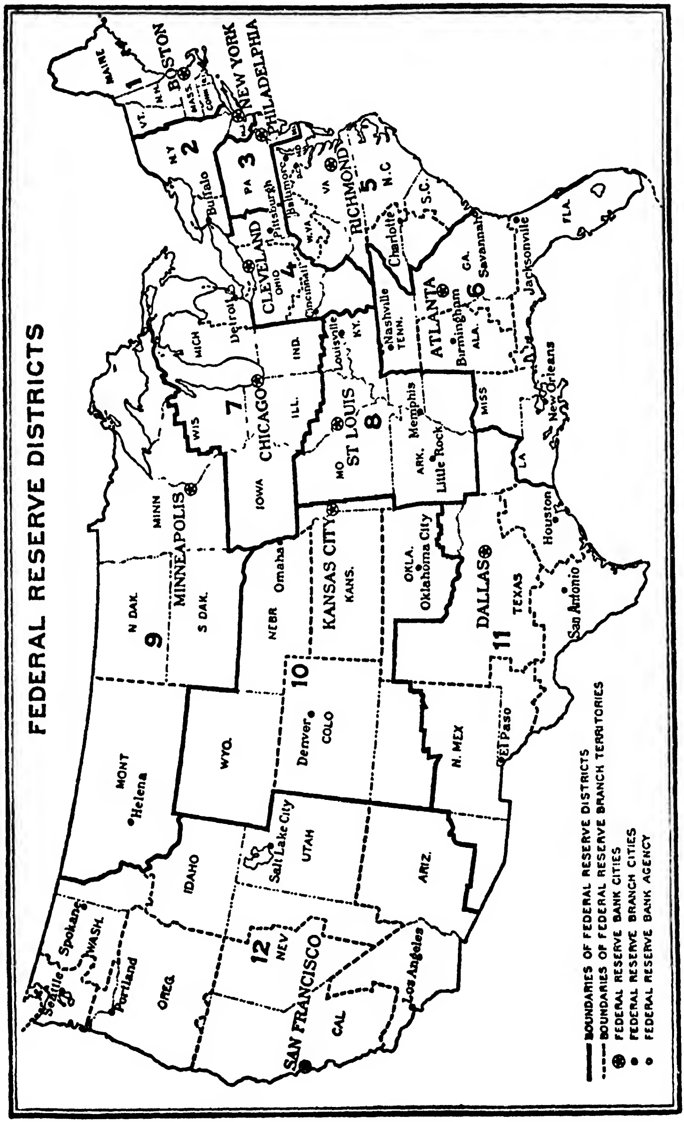
The Bank of England thus occupies the key position in the British financial system ; for it regulates the amount of credit as well as that of currency. Indeed, in these days its power to regulate credit is a good deal the more important of the two ; for the demand for currency largely follows as a logical conclusion upon the amount of credit that is created, and in reality the fundamental task of the Bank of England is to determine how plentiful credit ought to be and then to adjust the supply of currency to the credit policy thus determined. It could do this far more adequately, as we have seen, if it were left free to manage the supply of currency without any obligation to hold a reserve of gold against it, or any legal limit to the fiduciary issue. A managed currency policy is in fact simply the logical complement to a managed credit policy such as already exists.

§5. BANKING IN THE UNITED STATES

THE BANKING system of the United States of America differs considerably from that of Great Britain, not only in its structure and working, but also in that it has been to a great extent deliberately created by legislation, whereas the British system has grown up gradually without ever being planned as a unified whole. The present American banking system, indeed, dates only from 1913, and was set up directly as a result of the great financial crisis of 1907, which clearly demonstrated the need for a greater degree of central control over American banking operations than had previously existed, and showed the dangers of a rigid regulation of the issue of currency unaccompanied by any co-ordinated control over the supply and direction of the credit provided by the banks.

The great size of the United States and the pronounced differences in the economic character of different parts of the country made impossible the natural growth of a centralised financial system such as grew up gradually in Great Britain. New York is almost as much the financial centre of America as London is of Great Britain as far as stock market operations are concerned ; but it is not, like London, also the effective financial centre of the greater part of the industry and commerce of the country. It would indeed be impracticable to conduct the vast productive and trading operations of the United States from any single centre, or to bring the financing of these operations directly under the control of any centralised system of banking institutions located in a single town. The size and the geographical distribution of industries and population have in the United States necessarily involved a more decentralised banking system than is suitable for such a country as Great Britain.

But the great measure of decentralisation that used to exist in American banking before the passing of the Federal Reserve Act was not due to this cause alone. It arose also


FEDERAL RESERVE DISTRICTS
BOSTON
NEW YORK
PHILADELPHIA
CLEVELAND
RICHMOND
ATLANTA
CHICAGO
ST LOUIS
MINNEAPOLIS
KANSAS CITY
DALLAS
SAN FRANCISCO
BOUNDARIES OF FEDERAL RESERVE DISTRICTS
BOUNDARIES OF FEDERAL RESERVE BRANCH TERRITORIES
FEDERAL RESERVE BANK CITIES
FEDERAL RESERVE BRANCH CITIES
FEDERAL RESERVE BANK AGENCY

out of the federal structure of the American political system, which enabled banks to be established under the laws of the separate States, and allowed each State to have its distinct banking law with special features of its own. Even when the inconveniences of this system had led, in 1864, to the creation of national banks operating directly under Federal law, the State banks still continued in existence side by side with the new national institutions; and no attempt was made to create a Central Bank or even a system of Central Banks corresponding at all to the Bank of England. Moreover, American legislation looked askance at branch banking, and the typical American bank continued to be a local institution without branches, performing services for the industry and trade of a particular town or neighbourhood. It is true that there grew up, especially in New York, very large national banks doing an extensive business in many respects like that of the joint stock banks in England; but, whereas by far the greater part of the deposit banking in England is concentrated in the hands of the five great joint stock banks, in America there are still twenty-four thousand banks, not including other financial institutions which do a certain amount of banking business of one kind or another. These twenty-four thousand banks survive even after a considerable amalgamation movement since the war. In 1913 the banks of the United States numbered over thirty thousand.

National and State Banks. Of the twenty-four thousand American banks which were still in existence in 1930 some eight thousand were national banks operating under Federal law, and more than twice this number State banks under State law or Trust Companies of one sort or another. All the eight thousand national banks were compelled by law to belong to the Federal Reserve System; for the others membership was optional, and only about one thousand of them had taken advantage of the opportunity to join. The Federal Reserve System as a whole thus represented not much more than one-third of the total

number of banks in the United States, although it included a far higher proportion of the total capital invested in banking, as the banks which belonged to the system included most of the large and important institutions.

The primary aim of the Federal Reserve Act was to equip the American financial system with institutions capable of undertaking Central Banking functions—that is to say, primarily the regulation of the currency and of the volume of credit available. The framers of the Act set out to supersede the separate gold and cash reserves which had been kept by an enormous number of banking institutions by more concentrated and mobile reserves held by a small number of banks working as parts of a unified system and in some degree under a common control. For the old system, by which every important bank kept its own reserves and the lesser banks depended upon the reserves of the larger institutions, had been found to result in very great inconveniences and dangers. It was quite possible for an acute shortage of currency and credit in one part of the country to co-exist with an over-supply of financial resources in another ; and it was impossible to secure that one bank should come effectively to the aid of another when difficulties arose. This was partly a matter of distance ; for the actual clearing of cheques between banks in different parts of the country took a considerable time. But it was due also to the lack of any effective co-ordination, and to a great inelasticity in the supply of currency under conditions which made the power to create notes depend on the separate supplies of gold in the possession of each national bank.

The Federal Reserve System. There had then to be co-ordination of the American banking system ; but there could not be centralisation such as exists in Great Britain or Germany. Accordingly a somewhat different system was adopted. Instead of setting up one Central Bank for the whole country, the Federal Reserve Act created twelve in the most important financial centres in each broad area ;

and at a later stage these twelve Federal Reserve Banks were given the power to open branches in other centres of secondary importance. But the twelve Federal Reserve Banks were not to be wholly independent institutions. Their work was to be co-ordinated and in some degree controlled by a Federal Reserve Board entrusted with the supreme regulation of banking policy for the United States as a whole.

It is an interesting and significant fact that, whereas American industry in general is far less tolerant of any measure of public control than industry in the European States, the new American banking system is to a great extent a Government affair. The Federal Reserve Board consists of seven persons directly appointed by the Federal Government, including the Secretary of the Treasury and the Controller of Currency in their official capacities. It is thus in form purely a public institution. The twelve Federal Reserve Banks, on the other hand, are half public and half private ; each of them is governed by a board of nine members, of whom six are appointed by the national and other banks which are members of the Federal Reserve System within the area covered, and the remaining three by the Federal Reserve Board. Of the six persons appointed by the member banks three are bankers directly representing these member banks ; and the other three have to be chosen as representatives of the business community in the area, including agricultural as well as industrial interests. In order to co-ordinate the policy of the Federal Reserve Banks and keep them in close touch with the Federal Reserve Board itself, there is also a Federal Advisory Council with twelve members—one for each Federal Reserve Bank—and this Council meets regularly for discussion with the Board. The Board is not itself a bank, and has no direct relations with the public ; but it undertakes certain of the functions which are entrusted to the Central Banks of other countries, and it has notably the final responsibility for the regulation of the currency.

The Federal Reserve Banks. Thus the functions which belong to the Bank of England or the Reichsbank or the Banque de France are in the United States distributed between the Federal Reserve Board and the twelve separate Federal Reserve Banks. These twelve banks are in theory of equal standing and importance ; but in practice the concentration of a large amount of purely financial activity in New York, especially in connection with the stock markets, has caused the New York Federal Reserve Bank to assume an importance far ahead of the rest, and has made its discount policy play fully as important a part in American monetary conditions as the Bank of England with its power of fixing Bank Rate and its open market policy plays in Great Britain. One great object in view when the Federal Reserve Act was passed was to prevent the undue concentration of funds in New York, and thus check the tendency to excessive speculation on the stock markets which had so often led to crises and panics in the United States. The events of 1928 and 1929, however, showed clearly that this object had not been secured. For the Federal Reserve System found itself powerless in the boom to prevent the inflow of funds to New York, or to check the speculative excesses of the New York stock market. But apart from this very serious defect the Federal Reserve System did give the American banking institutions a far greater degree of stability than they had previously possessed, and did result in a more elastic credit and currency policy and a better distribution of banking resources over the country as a whole at normal times.

As we have seen, all national banks were compelled by law to join the Federal Reserve System, whereas for other institutions membership was left optional. Any bank which joined the Federal Reserve System ceased to hold legal reserves of its own against its obligations, and these reserves were replaced by deposits in the Federal Reserve Banks. Each member bank was compelled to keep at its Federal Reserve Bank an amount bearing a definite proportion to the sum-total of its liabilities to its depositors. This

proportion varied from bank to bank, according to the different conditions of the different areas. But in any case the Federal Reserve Banks paid no interest on the sums which they held as deposits from the member banks. This was the main reason why the great majority of the State banks did not take advantage of the opportunity of joining the system ; for it suited them better to keep their deposits in one of the member banks and thus to depend upon it for their supply of cash. The hope that the Federal Reserve System would before long come to include the vast majority of banking institutions in the United States, large and small alike, has thus come to nothing ; but it may well be that at some future date the State banks which remain outside the System will be placed under a legal compulsion to join. During the present depression the number of bank failures has been far larger among the small banks which are not members of the Federal Reserve System than among the member banks.

Rediscounting of Bills. The most important service which the Federal Reserve Banks provide for their members is the granting of loans which the member banks can then use as a basis for their own lending. This is secured by allowing the Federal Reserve Banks to rediscount bills and other negotiable instruments on behalf of the member banks. It seems to have been the intention when the Act was passed that these facilities should be supplied chiefly in respect of trade bills ; but in practice they have been made available, to a far larger extent, in connection with other types of paper, such as promissory notes of the depositors of the member banks, and even paper drawn for the purpose of stock speculation, provided that it is backed by United States Government securities. Only one-fifth of the credit advanced to the member banks by the Federal Reserve Banks in fact consists of advances in respect of the rediscount of commercial bills.

The member banks thus now depend for their supply of credit on the Federal Reserve Banks ; and the issue of notes

is gradually being concentrated in the hands of these banks. Before the Federal Reserve System came into being, the note circulation of the United States consisted of an enormous number of separate issues by the different national banks. These banks have not lost their rights ; but more than half the total circulation has in recent years consisted of Federal Reserve Bank notes, and the intention is that this proportion should steadily increase. The Federal Reserve Banks have the right to issue notes with a 40% gold backing, the rest of the cover being provided by securities of a liquid kind. America thus works under a currency system different from that of Great Britain, both because Treasury notes and notes issued by various national banks exist side by side with the notes of the Federal Reserve System, and because the Federal Reserve notes are issued not under the system of a fixed fiduciary issue but under the alternative system of a proportionate gold reserve. This feature of American as distinct from the British Central Banking methods has been adopted in most of the new Central Banking institutions that have been set up by other countries since the war. Its effect of course is to make the note issue more elastic ; for whereas in Great Britain the addition of one pound's worth of gold to its stock only enables the Bank of England to issue one additional £1 note, and a contraction of £1 in the supply of gold only causes one note to be withdrawn, under the proportional system both the increase and the decrease consequent on a change in the supply of gold are considerably greater. But in the United States this provision has not been of great importance hitherto, because the very large accumulation of gold in America has always caused the reserves of gold to be kept at a substantially higher level than the permitted minimum.

The twelve Federal Reserve Banks, and especially the Federal Reserve Bank of New York, are thus the pivots on which the United States banking system turns. The obligations of one Federal Reserve Bank to another are secured by means of a centralised Gold Settlement Fund at Washington ; and this fund thus fulfils the same function in

respect of the various banks as the transfer of deposits of the joint stock banks at the Bank of England performs in Great Britain. In addition each Federal Reserve Bank acts as a clearing-house for its member banks, and also as a banker for the Government. The United States has thus equipped itself with a fully developed system of Central Banking under a considerable measure of Government control, but has adapted the banking practice common in Europe to the needs of a country far more extensive in area and far vaster in population and resources.

How The Federal Reserve System Works. Up to the boom and slump of 1929 the new American banking system was subjected to no really serious strain, for the abundance of gold at its command left the banking authorities free to adopt a managed system of credit and currency almost without regard to international complications. Bank Rate does not indeed exert the same influence over American financial conditions as it does in Great Britain. For whereas, as we have seen, borrowing from the Bank of England is an exceptional measure resorted to by bill brokers and discount houses only in times of strain, it is part of the normal business of the American Federal Reserve Banks to grant rediscounting facilities to their members. Moreover, whereas in Great Britain the joint stock banks never borrow from the Bank of England, but on the contrary always maintain substantial balances with it, the American rediscounting system causes the member banks to borrow constantly from the Federal Reserve Banks. The American Bank Rates—for example the rediscount rate fixed by the Federal Reserve Bank of New York—thus bear a different relation to market conditions from the British Bank Rate ; and a change in the rate at which the New York Federal Reserve Bank is prepared to rediscount bills or other paper exerts no such commanding influence over monetary conditions in New York as a change in Bank Rate does in London. This comparative ineffectiveness of Bank Rate has caused the authorities to place even greater

reliance than the Bank of England on their open market policy—that is to say, on regulating the supply of credit by the buying or selling of securities in the market. For the regulation of this policy there exists a special Open Market Committee of the Federal Reserve System, consisting of one member from each of the five Federal Reserve Banks in the eastern area of the United States. It was chiefly by means of this open market policy that the Federal Reserve System in the years before 1929 attempted to keep commodity prices stable, and to check the growth of speculative movements. But these two objects proved in fact to be largely inconsistent; for the maintenance of a sufficient volume of credit to stabilise prices in face of the increasing productivity due to rationalisation could not be secured without allowing a growing volume of funds to find their way into the stock markets. Moreover, owing to the existence of a large number of financial institutions connected only loosely, if at all, with the Federal Reserve System, but with substantial funds at their command, it was easy for money to flow into stock speculation in ways which were beyond the control of the Federal Reserve Banks. There is thus even to-day far less co-ordination in the American financial machine than exists in Great Britain; and the Federal Reserve Board and its associated banks are far less in a position to dictate the credit policy of the banking world as a whole.

The Growth of Overseas Business. A pronounced feature of the development of American banking in recent years has been the growth of overseas business, which has been largely in the hands of the great Trust Companies and of financial institutions standing on the verge of the Federal Reserve System. America's new position as a great creditor country has forced her to pay far more attention than before to foreign financial conditions, and the growth of American overseas lending has been accompanied by the creation of a rapidly growing number of overseas branches of American banks as well as by a participation of American financial

BANKS AND BANK SUSPENSIONS IN THE UNITED STATES

	BANKS IN EXISTENCE (JAN. 1932)		BANK SUSPENSIONS (1930-1)	
	Number	Deposits ($ millions)	Number	Deposits ($ millions)
Federal Reserve Banks	12	—	—	—
Banks belonging to Federal Reserve System, National	6,368	29,470	570	612
Banks belonging to Federal Reserve System, State	878		134	502
Banks outside Federal Reserve System	12,722	19,683	2,939	1,442
TOTAL	19,980	49,153	3,643	2,556

institutions in the work of banks centred overseas. These developments, however, have been largely unco-ordinated ; and America has not yet succeeded in establishing an effective market in New York for the discounting and acceptance of commercial bills for the financing of overseas trade. The main interest of the American banker continues to be directed to internal conditions ; and American banking policy is still mainly governed by purely national considerations. Indeed one of the principal effects of the great stock market collapse of 1929 was to cause American bankers to contract as far as possible their foreign obligations. There was a considerable movement to recall money that had been deposited or lent at short term overseas by banks which the domestic position compelled to call up all the liquid resources they could lay hands on. This arose largely because the American banks, at the time of the stock market boom, had made huge advances on the strength of securities which at that time possessed a grossly inflated market value. The collapse of security prices left these banks in many cases with insufficient cover for the loans which they had made ; and in addition they were large holders themselves of securities which had depreciated greatly in value. Owing to these causes there was throughout the years following the stock market collapse a great wave of bank failures in the United States. Bank after bank found itself unable to meet its obligations and was compelled to close its doors ; and even those banks which successfully weathered the storm found themselves with greatly diminished resources and with a large part of their funds locked up in securities which could only have been realised at enormous loss and with a certain consequence of causing a huge further fall in stock market values.

§6. BANKING IN OTHER COUNTRIES

IN OUR survey of banking institutions in Great Britain and America we have seen that the banking system as a whole consists of two main types of institution, of which one is concerned mainly with the regulation of the currency and of the total volume of credit available for lending, while the other has to do with the actual distribution of the available resources among the various applicants. The first of these two functions is essentially the function of Central Banking, while the second is usually combined with deposit banking —that is to say, with the holding of the liquid resources belonging to the public and the transfer of these resources from one person to another. Round these two essential functions a number of other functions are grouped in varying ways. There is, for example, the whole business of accepting and discounting bills and other forms of commercial paper, which is everywhere an important activity of the financial system ; and there is also the provision of long term credits or of actual capital for business undertakings of varying kinds, which may or may not be a normal function of the institutions engaged in general banking.

Nowadays every advanced country possesses a Central Bank which is mainly responsible for the regulation of its currency and for the general direction of credit policy ; and practically all these institutions are modelled in varying ways either on the Bank of England or on the Federal Reserve System of the United States. In structure they are usually like the Bank of England, in that the needs of most countries are best served by a single Central Bank ; but a number of features from the American Federal Reserve System, and especially that of proportionate gold reserves in preference to a fixed fiduciary issue, have been grafted on to the structure of most Central Banks in imitation of the Federal Reserve System.

The Central Banks of most countries also resemble the Federal Reserve Banks rather than the Bank of England in

that they undertake business which in England is left almost exclusively either to the joint stock banks or to specialised financial institutions such as the Acceptance and Discount Houses. Thus the Bank of France not only acts as a Central Bank in regulating the currency but also through its numerous branches undertakes directly the discounting of trade bills. The trade bill in France occupies a quite different position from its position in Great Britain ; for the French do not normally settle their internal business transactions by means of cheques or simple transfers in a current account standing to their credit in the banks. The trade bill is in France the normal method of financing internal as well as external transactions, and under the French currency system the cover for the internal note issue consists, apart from gold, of these domestic trade bills, which are bought by the Bank of France and held against the issue of notes. In Germany the Reichsbank is also an institution with many branches, and conducts an active business as a deposit bank in addition to its Central Banking functions. The Central Banks of Germany and France, which are typical in this respect of Central Banking institutions in most other countries, have thus a far closer connection than the Bank of England with trade and industry ; and this extension of their functions naturally tends to involve them in a far greater amount of direct competition with other banks within the national system.

Continental Banking Practice. Nor are these other banks in most continental countries, or indeed in the United States, quite like the joint stock banks in Great Britain. Until recently there was a sharp divergence between Great Britain and most other countries in banking practice. The British joint stock banker regarded himself primarily as the custodian of his customers' deposits and as an agent for the granting of short-term advances to industry and trade by way of overdraft. He did also undertake some amount of bill discounting and acceptance business in competition with the Discount and Acceptance

Houses ; and the importance of his work in these fields had increased as a result of the great amalgamation movement in British banking. For the " Big Five " in the course of this movement absorbed into themselves a number of smaller institutions which had been conducting a more diversified type of business ; and these additional functions were retained when the amalgamations had taken place. The British banker, however, still continued to regard himself as essentially the holder of resources which must at all costs be kept liquid ; and he was only prepared in normal cases to advance money for quite short periods of time. The continental banker, on the other hand, was in most cases far more directly concerned with the making of long- as well as short-term advances to industry ; and many continental banks were primarily industrial, and had close connections with particular industries and great business firms. Thus in Germany the *Disconto Gesellschaft* was regarded as primarily the bank of the heavy industries, while the *Dresdner Bank* had a very close connection with Krupp's ; the *Deutscher Bank* was largely concerned with the financing of export trade, while the *Darmstadter und Nazional Bank*, in addition to its relations to home industry, was largely concerned with financing business in Eastern Europe. A somewhat similar situation existed in France ; but there certain of the leading banks—notably the *Crédit Lyonnais*, the *Société Générale*, the *Crédit Industriel et Commercial* and the *Comptoir National d'Escompte de Paris*, had come to be conducted in most respects very much like the " Big Five " in Great Britain. There has also been since the war a notable tendency in German banking to reorganise itself more on the British model, and to reduce long term commitments where opportunity has arisen. But the extreme stringency of credit conditions in Germany, and the freezing of a large part of the assets of the great German banks in consequence of the slump, have made it impossible for them to realise this ideal of liquidity to anything like the same extent as has long been achieved in the British banking system.

In both France and Germany, and indeed over the whole

of Continental Europe, banking is far less centralised than in England ; and the situation resembles more closely that of the United States, with its vast number of purely localised banks conducting in many cases only a specialised type of business or related closely to a particular industry or group of undertakings. Many of the Continental banks are in effect not mainly deposit banks but rather credit institutions existing for the purpose of finding resources for some particular group of businesses. Under these circumstances they require, as we have seen, a larger amount of capital of their own in relation to the magnitude of their operations than the British joint stock banks ; and it is far more natural for them to help in meeting the long-term as well as the short-term requirements of the businesses with which they are connected. They have tended to do this also because in most European countries there does not exist an investing public on anything like the scale of the investing public in Great Britain. The British company of standing, when it needs fresh capital beyond what it can accumulate out of its own reserved profits, usually makes at once a public appeal for subscriptions. It places this new issue of capital usually through a specialised financial institution called an Issuing House ; and it usually makes provision for underwriting the issue through this same Issuing House—that is to say, it pays a commission on the amount of capital to be issued, and in return for this commission the underwriters agree to take up themselves any part of the issue for which the public is not prepared to subscribe on the advertised terms. The business is thus sure of getting the capital it wants before the issue is made ; and the underwriters, if they have to take up a part of the issue, then hold it until they see a favourable opportunity of selling it off to the investing public.

This long-established financial mechanism obviously depends for its successful working on the existence of a large investing public ready to subscribe for new issues of industrial shares. But in many of the Continental countries no corresponding public for new shares can be said to exist. For either there is a great shortage of capital in the country,

so that a large part of the capital has to be provided directly or indirectly from abroad, or where, as in France, there is plenty of capital, the investing public nevertheless fights shy of ordinary industrial issues, and shows a marked preference for gilt-edged Government securities. In these circumstances it is impossible for business houses to appeal confidently to the public for the subscription of new capital which they require; and consequently the practice has grown up of selling new shares to banks and other financial agencies, which then either hold them or at a convenient opportunity transfer them to their own customers. In practice this system results in a part of the long-term requirements of Continental industry being financed not by capital made up out of the savings of the public but by bank credit which is often borrowed from abroad at short-term by the banks, which thus take the risk of putting it to long-term use. Banking conducted under these conditions is inevitably far more risky than joint stock banking as pursued in Great Britain; but the different practice arises mainly from the differences in needs and opportunities and in the attitude of the investing public.

§7. THE CONTROL OF CREDIT

FINANCE by itself produces nothing; and money is of value only for the buying of things. It is therefore plainly wrong for monetary conditions to govern industry, or for production to be made the handmaid of finance; for the aim of money is to facilitate the production and consumption of goods and services, and the monetary machine ought accordingly to be adapted to serve the interests of production and consumption. In the foregoing parts of this section we have surveyed the working of the monetary machine in certain of the leading countries and have made tentative suggestions for the future regulation of the world's currencies. But it remains to consider how the monetary

machine can be adapted to serve the needs of production in its other aspect, in which it is concerned with the supply of credit.

Credit is in the modern world fundamentally more important than currency. It is doubtless indispensable for communities to have a sufficient supply of actual currency to meet the needs of the smaller everyday transactions ; but the amount of currency that is required for these purposes depends at bottom on the volume of business activity, and is therefore determined mainly by the abundance or scarcity of credit. The regulation of the issue of currency is an important matter ; but it ought to be made secondary to the regulation of the volume and distribution of credit. Currency ought not to govern credit as it does largely in the world to-day.

This is where many of the financial reformers of the present day go wrong ; for they seek to set conditions in the banking world right by reforming the currency rather than by bringing the credit system into harmony with industrial needs. It is a matter of comparatively small importance what form the issue of currency takes, though it is of the greatest importance that the amount of currency issued should be in a right proportion to the amount of credit created. We may therefore dismiss without further argument those " currency cranks " who hope to put an end to the world's troubles by providing new forms of currency which will automatically depreciate if they are not spent, or by issuing two separate forms of currency—one for the making of everyday purchases and another for the conduct of business transactions. Different currency reformers have produced endless variations upon these themes ; but not one of their schemes really goes to the root of the matter.

There is far more substance in the proposals of those monetary reformers who concentrate their attack upon the existing system on the problem of credit. In one way or another, most credit reformers aim at securing a more abundant distribution of credit in the community, in accordance rather with the needs of industry than with the

amount of gold or other liquid assets in the possession of the banks. They have seen that money ought to be the handmaid of industry, and that accordingly productive power ought never to be damped down by a denial of the necessary credit facilities. They have sought accordingly to base the issue of credit upon the available volume of productive power, and to ensure the issue of sufficient supplies of credit to keep all the productive resources in the possession of the community fully employed.

Where Credit Reformers Go Wrong. So far so good; but some of these credit reformers have been so carried away by their enthusiasm as to suggest that, if credit were issued in the right abundance, it would be possible not only to increase the supply of commodities in proportion to the magnitude of the available productive power but also to reduce the prices of goods and services to a fraction of what they now are. It is of course true that the full use of the available productive resources would make possible considerable economies in cost owing to the advantage which could be secured by spreading fixed charges over a larger volume of output. This advantage would be to some extent offset by the bringing into use of productive resources and of human labour on the average somewhat less efficient than those now in employment; but it is safe to say that on balance the full use of the available productive power would bring about a substantial reduction in costs. It is nevertheless fantastic to suggest that prices could be halved, or brought down to a fraction of what they now are, by any manipulation of the monetary machine. And those reformers who suggest that a vast amount of new money could be constantly pumped into circulation without any effect in raising prices can also be dismissed without further argument. For, difficult as it is to formulate accurately or to make much practical use of the Quantity Theory of Money, there can be no doubt that this theory does hold broadly good, and that the supply of money, including credit, can be increased without raising

prices only to the extent to which the supply of goods and services can be increased in proportion.

The object of the banking system should be, then, to supply credit in amounts adequate to secure the fullest possible utilisation of the available productive resources without any tendency towards an artificial raising of prices. But how can this be done? Bankers to-day have a strong inducement to lend money whenever they think they can make an adequate profit on the loan; for the more money they lend, provided the borrowers are solvent, the larger are the total profits which they stand to make. The banker certainly has no wish artificially to restrict the volume of his loans; for money idle in his hands is money that earns nothing.

Why is Credit Restricted? Why then is the banker deterred from lending more freely? Chiefly by two considerations. In the first place he is held back by the limitations upon his lending imposed by the necessity of keeping a certain proportion between the volume of his outstanding deposits and the supply of "cash" on which he is able to lay his hands. This "cash," as we have seen earlier in this chapter, consists not only of actual currency, but also of deposits held by the banker at the Central Bank, or of other holdings which are immediately convertible into currency. For such assets, being convertible into currency at will, are regarded by him as the equivalent of "cash." He is held back, in the second place, by the need for lending only to solvent borrowers; for he wants to be reasonably sure that the loans which he makes and the interest upon them will be punctually repaid. In times of business prosperity the limit to his lending is set mainly by the first of these considerations; but in times of depression the second consideration comes powerfully into play. For it is difficult then for the banker to find a sufficient number of borrowers on whose ability to repay his loans he can reasonably depend. It follows that in times of prosperity the limit to the amount of credit issued by the

ordinary banks is set mainly by the Central Bank which, as we have seen, possesses the power by open market operations to increase or decrease the amount of " cash " at the disposal of the ordinary banks. But in times of depression the Central Bank has far less power over the volume of credit, though it can, by continually pumping fresh monetary resources into the market, embarrass the ordinary bankers by placing more and more " cash " at their disposal. This gives the bankers a strong inducement to lend, for as long as money remains in their hands as " cash " it earns no interest. But, even so, they may prefer earning nothing on it to lending it to borrowers whose ability to make repayment they profoundly mistrust.

I am writing at a moment when bankers in general are in an exceptionally mistrustful mood. The Federal Reserve Banks of the United States are endeavouring, by open market operations, to increase the amount of money in circulation, in order to force the ordinary American banks to create more credit ; but the American banks are reluctant to do this, and are instead using the new money which comes into their hands for the purpose of repaying the sums which they owe to the Federal Reserve Banks. It should be noted that, whereas in Great Britain the Joint Stock Banks always keep large sums on deposit at the Bank of England, and do not borrow from it, in the United States the member banks regularly rediscount trade bills and other eligible " paper " at the Federal Reserve Banks. They can thus offset fresh creations of money by the Federal Reserve system by reducing their borrowings from the Reserve Banks, whereas this device is not open to the Joint Stock Banks in Great Britain. For this reason it is easier to increase the supply of money by " open market operations " in Great Britain than in the United States ; but even in Great Britain the swelling of deposits in the Joint Stock Banks by this means will not necessarily induce bankers to lend more, if they deeply distrust the solvency of potential borrowers. It is more likely in such circumstances to cause them to buy more gilt-edged securities, and

thus to set up a boom in the bond market. This, of course, has the same effect as " open market operations " by the Central Bank in swelling their deposits and making money easier. But, even so, the available money may not be used for production, but left idle in the banks. " Open market policy " thus encounters serious obstacles to its effectiveness in increasing the supply of credit. But, even in the United States there are limits to the extent to which the ordinary banks can neutralise the " open market policy " of the Central Bank ; but until these limits have been passed the open market operations of the Federal Reserve Banks are not likely to be of great effect in increasing the amount of credit. If the Federal Reserve Banks persist in their present policy they can, I think, in the end force the ordinary banks to increase their advances ; but the ordinary banks will not do this unless their hands are forced, because of their extreme mistrust of the solvency of potential borrowers.

In London the situation is somewhat different, because as we have seen, it is not the practice of the joint stock banks to borrow money from the Bank of England. But in London too the bankers' mistrust of the solvency of potential borrowers is exerting a powerful depressing influence on industry and trade. It is resulting, for example, in a contraction of the acceptance credits by means of which international trade is ordinarily financed, as well as in a reluctance on the part of the banks to make advances for fresh industrial enterprise. In London, however, the Bank of England can bring pressure to bear upon the ordinary banks more easily and effectively than the Federal Reserve Bank in New York. And a steady pursuit of open market policy by the Bank of England would have a reasonable chance of resulting speedily in a real expansion in the volume of credit.

Why, then, is this policy not being pursued or pursued in greater measure ? Largely because the Bank of England is afraid that the effect of pumping more money into circulation at the present juncture will be to raise prices in Great Britain without a corresponding rise in other countries. It

is safe to suggest that, if the Federal Reserve System succeeds in enforcing a policy of expanded credits upon the American banking world, London will be far more disposed to follow suit, and to embark upon a corresponding policy of expansion ; for the fear will no longer exist of upsetting the equilibrium of the London money market through a disharmony between monetary movements in London and New York. In fact, the credit policy which can easily and safely be pursued depends very largely on what is happening in other competing centres.

Even, however, if there were no obstacles to the increase in the supply of monetary resources by the action of the Central Bank, it is probable that a policy of credit expansion would, under present conditions, meet with considerable resistance from the ordinary banks. For the minds of bankers are pervaded at the present moment by an acute nervousness. A substantial fraction of the short-term credits which they have advanced in recent years both for home production and for overseas trade has become " frozen." Sixty million pounds of British short-term advances are thus " frozen " in Germany under the " Standstill " Agreement ; and there are large sums similarly " frozen " in every distressed country throughout the world. In much the same way, a great mass of ordinary industrial overdrafts cannot be recalled for fear of bringing down the firms which borrowed the money. The banker is therefore disposed to contract rather than to expand his operations, and to convert as large a part of his resources as he can into a fully liquid form in order to offset the " freezing " of his past advances. The fear of loss is at present more powerful in his mind than the hope of gain ; and he would rather earn nothing on a substantial fraction of his resources than run the risk of further losses and of sleepless nights spent in wondering about the solvency of his debtors.

In these circumstances the obstacle to the expansion of bank loans lies less in any regulations or observances of the banking system than in the panic fears which dominate the minds of those who are responsible for its conduct. It

may be possible, by extreme pressure from the Central Bank, to induce the ordinary banks to expand their loans ; but this involves that the Central Bank itself should be immune from panic and should follow a courageous and even, according to orthodox conceptions, a rash and risky policy. For the fears of the bankers are in fact to a great extent justified. It is difficult at the present time of acute business depression to find solvent borrowers, or to feel any confidence that even borrowers who appear solvent to-day will still be solvent when the time comes for the repayment of their loans. This applies in even greater measure to loans required by overseas borrowers than to ordinary industrial advances in Great Britain ; and in the case of advances for the financing of foreign trade there is the further difficulty that, owing to the exchange restrictions enforced by a large number of Governments, it is often impossible to recover in British currency sums lent abroad. The individual foreign debtor may be able enough to repay in *pengos* or *reichsmarks* or *zlotys* ; but his government may refuse to allow the foreign currency to be converted into British or American money. Accordingly it is not surprising that the banker holds back from lending, and prefers to keep his cash resources unused, even if for the time he makes nothing by them.

How Can Credit be Expanded? What then is to be done in order to bring about an expansion in business credit ? Without this expansion it would be impossible for industry to recover even if the other conditions of recovery were fully present. In many countries Governments have in one way or another endeavoured to step into the breach by the grant or guarantee of credits, chiefly for purposes of export, which the ordinary banks would not have been prepared to advance, at any rate without the Government's guarantee. Great Britain has her Export Credits Scheme ; and German external trade has been financed largely with the aid of credits placed by the Government at the disposal of the impecunious manufacturers and traders. Governments

usually endeavour to work schemes of this sort on a self-supporting basis, by charging for their guarantee a premium sufficient to cover the estimated amount of their losses from bad debts. But in some cases export credits have come to include an actual element of subsidy, in that the premiums charged have not been large enough to cover losses. Indeed, the power of Governments, merely by granting export credits, to increase appreciably the total volume of credit is very limited as long as they attempt to make their schemes self-supporting. For the risks which make the ordinary bankers reluctant to lend are real risks ; and the premiums needed in order to cover them are often so high as to deter the potential borrowers. Governments can doubtless do a good deal more to increase the volume of credit if they are prepared to supply credits for risky types of business at a loss ; but most Governments, in these days, are more disposed to retrench than to incur fresh expenditure, and there is the additional difficulty that the granting of credits on terms involving a subsidy by Governments would be resented as unfair competition by the ordinary banks, and might put the insolvent borrower in a preferential position in comparison with his more solvent competitors.

The system of Government credits in aid of export trade has therefore only a limited, though an important, use. It ought to be pushed further than it has been hitherto ; but there lies in it no hope of bringing about a real trade recovery. Schemes of this sort, moreover, are usually confined to the financing of export business ; and assistance is not available for production designed for the home market. But, in face of the cutting down of imports by countries anxious to improve their balance of trade, there is not much room at present for a stimulation of exports by this means.

In the United States the Government has come to the help of business in a somewhat different way, through the Reconstruction Finance Corporation formed at the end of 1931. This body was designed mainly to give assistance to banks and similar bodies in " unfreezing " their " frozen " resources, and thus enabling them to release money for

new lending. The Corporation itself was not designed to undertake or directly to promote new business; but indirectly it has the effect of promoting new loans by releasing the "frozen" assets of the banks to which it gives help. Its effectiveness, however, in bringing about a real expansion of credit is limited by the consideration which has been already discussed; for the banks need not use the liquid resources placed at their disposal for an increase of lending, nor will they readily do so until they can feel more confidence in solvency of borrowers.

From what has been said above it will be seen that the effectiveness of measures aiming at the provision of additional liquid resources out of which more credit can be granted to industry depends in the last resort on the existence of borrowers ready to take advantage of the facilities and considered as loan-worthy by the banks. But the solvency of borrowers is far less a question of the efficiency of the borrowing firm itself than of the general condition of business activity. For the ability of firms to repay loans depends on their success in selling goods and getting paid for them; and this in turn depends on the ability of buyers to meet their bills, and on the readiness of Governments to allow payment to be made across national frontiers. There are any number of borrowers to whom the banks at present hesitate to make advances, but of whose solvency there would be no doubt at all if a general improvement took place in the level of business activity. For solvency in one firm would breed solvency in others. For this reason the success of the policy of the making an additional supply of credit available for the business community depends on the taking of concurrent measures for the stimulation of demand for the goods which the borrowing businesses are in a position to make.

A Policy of Economic Development. A policy of credit expansion by itself is likely, then, to have a very limited effect in bringing about business revival. For if the banks, with or without Government support, grant

additional credits by lowering their requirements from borrowers and by taking a bolder view of the risks which it is reasonable to incur, the fresh sums which they lend may easily become "frozen" through the inability of the borrowers to make repayment at the appointed time. If this happens, the additional supply of credit will not, in the long run, afford any real stimulus to industrial revival. Indeed, it will only pave the way for further attempts on the part of the banks to restrict their advances as the new loans become "frozen" in their turn. The plain truth is that, while an adequate supply of credit is absolutely vital to business prosperity, the mere granting of additional credits cannot avail to bring prosperity out of depression unless at the same time an adequate outlet is ensured for the additional goods which the credits are to be used to create. For this reason, if Governments really desire to use their own resources for the purpose of stimulating a business revival, they will have not only to ensure the provision of additional credits through the banks but also by a positive policy of economic development to provide in the first instance the market for the expanded supply of goods. A mere expansion of credit will be of no avail unless it is accompanied by Government measures for the stimulation of demand through an extensive system of public works —housing, road making, slum clearance, and the reorganisation under public control of industries in need of fresh capital equipment.

Credit policy is thus not the autonomous agent of business revival, but only the necessary accompaniment of a practical policy of increasing the demand for goods and services ; but it is essential, if credit is to be expanded, side by side with Government measures for the stimulation of demand, that care should be taken to ensure the right use of the new financial resources placed at the disposal of the banking system. For otherwise a large part of the new money created may go, not into the stimulation of new productive effort, but rather into the purchase of fixed interest-bearing securities at prices which will bring down their yield to a

very low point. It is true that, if the purchase of such securities is pushed far enough, it is bound to react on interest rates, and so to cheapen money for the ordinary industrial borrower ; but it might take, especially in the United States, some time for this result to be brought about, and in the meantime the expansion of credit might have almost no effect on the stimulation of industrial activity.

It seems desirable therefore, if Governments are to come into the field in order to ensure the provision of additional credits, that they should also concern themselves directly with the uses to which the new money is to be put. They can do this in two ways—first by creating directly a demand for credit through the institution of large schemes of economic development, and secondly by the establishment of public control over the banking system.

The Socialisation of Banking. As we have seen, in most countries the Central Banks are at present in form private institutions, but are subject in varying degrees to Government control. The ordinary banks, on the other hand, are purely private bodies with which the Government has no authority to interfere, although they are subject in varying degrees to control by the Central Banks over the total volume of their lendings. Many financial reformers have urged that the Central Banks in all countries ought, as they now virtually are in the United States, to become public institutions under definite State control. But there have been sharp differences of opinion concerning the desirability of socialising the ordinary banks as well. Now, the socialisation of the Central Bank gives the Government of the country direct control over both the issue of currency and the total quantity of credit available to the ordinary banks for lending ; for, as we have seen, Central Banks, by means of Bank Rates and open market operations, are in a position to limit the total amount of credit which the ordinary banks are able to create. But the socialisation of a Central Bank would give the Government no assurance that the additional money made available

would be actually used, and no control at all over the uses made of the credits which the ordinary banks would be enabled to create. For, if they were left uncontrolled by the State, they would remain solely responsible for the distribution of these credits among different applicants. It seems clear, however, that, if any community sets out to carry through a definite plan of economic reorganisation and development, it is bound to be closely concerned not only with securing the availability of an adequate total volume of credit for the financing of this plan, but also with ensuring that the credit available shall be actually used, and with the right distribution of this volume of credit among different industries and firms. This, however, cannot be secured unless the ordinary banks as well as the Central Bank are brought under effective public control.

Where a community continues to rely on competitive private enterprise to secure an adequate output of goods and services, the logical complement to such a system of production is private ownership of the ordinary banks. But, as soon as a community passes over from a regime of unregulated private enterprise to one of co-ordinated economic planning, it becomes indispensable for it to control the distribution of the available supply of credit between different applicants as well as the total amount of credit available for distribution. Any system of organised economic planning therefore seems to involve the co-ordinated control of ordinary banking as well as of the Central Bank; and it is significant that in Great Britain the idea that the joint stock banks as well as the Bank of England ought to come under national control has made headway side by side with the development of the notion of national economic planning. The two things indeed obviously go together; for a national economic plan unaccompanied by control over the distribution of the available supply of credit might easily be brought to shipwreck by a divergence of ideas and policy between those responsible for the plan and the joint stock banks.

There seems accordingly to be a strong case for bringing

the distribution of credit, as well as the regulation of currency, under direct public control. But it is no easier to lay down any automatic rule for the supply of credit than for the regulation of the volume of currency. In both cases what is needed is not an automatic system applied by rule of thumb, but deliberate management designed to bring about the fullest possible utilisation of the available productive resources without an artificial inflation of prices. The volume of credit created by the banking system ought to be sufficient to ensure this full employment of the available resources ; and the supply of credit ought to be so distributed as to work in with the requirements of the national plan of production. The volume of currency in its turn ought to follow from these two things ; for enough currency will be needed to supply the demand which results from the amount of credit created and from its distribution among different uses. A managed credit policy, even more than a managed currency, is the foundation on which a rational banking system must rest. But such a policy is unattainable without the close co-ordination of the separate banks under unified control ; and co-ordination among these banks would obviously create far too powerful a monopoly to be left in private hands.

CHAPTER VII: UNEMPLOYMENT AND INDUSTRIAL FLUCTUATIONS

1. The Nature of Unemployment
2. The Burden of Unemployment
3. The "Trade Cycle"
4. Why Trade Fluctuates
5. The Present Slump

§ 1. THE NATURE OF UNEMPLOYMENT

IN JANUARY 1932, the figures published by the League of Nations showed well over thirteen millions of unemployed in the countries covered by the available records. Of this number, over six millions were in Germany alone, and not far short of three millions in Great Britain. Italy recorded over a million unemployed, and Czechoslovakia half a million. But this total of thirteen millions falls very far short of showing the total numbers out of work; for, in the first place, it leaves out altogether the United States, and secondly it is based for most other countries on very incomplete records. In the United States alone, the number of unemployed workers has been variously estimated at from eight to twelve millions; and, according to official returns, the volume of employment in manufacturing industry is less than two-thirds of what it was in 1926, and the total amount paid in wages only half as much. In France, the official records show only a quarter of a million out of work; but the real total is at least four or five times as large. And for many other countries there are no complete records. It is certainly safe to estimate that, at the beginning of 1932, there were at least 25,000,000 unemployed in Europe and America, and that this total was at least four times as great as the total of three years before.

THE GROWTH OF UNEMPLOYMENT, 1929-1932

	Source of Information	Numbers Unemployed in First Quarter of 1929 thousands	Numbers Unemployed in First Quarter of 1932 thousands	Unemployment in 1932 compared with 1929
Germany . . .	E.E.	2,484	6,128	2½ times as many
Great Britain . .	E.E.	1,204	2,809	2⅓ ,, ,, ,,
France . . .	E.E.	8.6	337	nearly 40 times as many
Italy	Estd.	309	1,174	,, 3 ,, ,, ,,
Belgium . . .	V.I.	27	333	12 times as many
Holland . . .	V.I.	52	191	3½ ,, ,, ,,
Denmark . . .	T.U.	60	106	⅔ rise
Sweden . . .	T.U.	44	93	twice as many
Norway . . .	E.E.	24	38	½ rise
Finland . . .	E.E.	3	21	7 times as many
Poland . . .	E.E.	170	344	twice as many
Hungary . . .	T.U.	17	34	twice as many
Austria . . .	E.E.	225	362	nearly ⅔ rise
Ireland . . .	E.E.	19	31	,, ⅔ ,,
Roumania . . .	E.E.	58	58	no change
Switzerland . . .	V.I.	3·3%	25%	over 7 times as many
Czechoslovakia . .	E.E.	50	626	over 12 times as many
Yugoslavia . . .	E.E.	12	21	¾ rise
Australia . . .	T.U.	39	119	3 times as many
Canada . . .	T.U.	12	41	3½ times as many
Japan	Estd.	269	471	¾ rise
U.S.A.*				

E.E. = Employment Exchange Statistics (including Compulsory Insurance Schemes).
V.I. = Voluntary Insurance Schemes (incomplete).
T.U. = Trade Union Statistics (incomplete). Estd. = Estimated figures of varying value.
*Index of Employment (1926 = 100). Figure for March 1929 was 99% ; figure for February 1932 is 66%.

Everywhere in the post-war world unemployment has been the most obvious and pervasive symptom of industrial disease. But it is important to realise that it is only a symptom arising out of disharmonies and maladjustments in the economic system. For, as every doctor knows, a symptom cannot be cured except by treating the disease, although the pain which it causes may be mitigated or even removed. There is no remedy for unemployment merely in terms of unemployment. The remedy has to be sought in setting right what it is wrong in the economic system itself. It is therefore necessary to look beneath the mere surface facts of the extent and duration of unemployment in the post-war world to what is amiss in the economic relations on which the offer of employment depends.

But, before we do this, it is desirable to see how far we can get to understand and to estimate the real nature of the unemployment which has existed in some degree of severity in every industrial country since the war. The crude record of the numbers unemployed at any particular time tells us but little until it has been analysed further. We need to see how the total volume of unemployment is distributed among workers in different industries and occupations, between men and women, adults and non-adults, workers of different ages and types and degrees of skill, and between different geographic areas within the country covered by the returns, and above all to what extent the same individuals tend constantly to be out of work, or the unemployed consist of a constantly shifting mass of persons who are in effect idle for a while between jobs. We want to see how far unemployment is seasonal, both generally and in particular trades, how far it results from the use in certain industries of large masses of casual and intermittent labour, and finally how far it is the result of fluctuations in general industrial activity which can be properly called " cyclical."

In the first place, it is a well known fact that in all countries which have suffered heavily from unemployment since the war the surplus of labour has come in a disproportionate degree from a certain group of industries. It has

been heaviest in shipbuilding, in the iron and steel trades, in engineering, and in coal mining ; and, if allowance is made for systematic under-employment or short-time as well as for complete unemployment, in the textile trades also. The incidence of unemployment as between these various trades has differed considerably from country to country and from time to time ; but almost always and everywhere they have together accounted for a disproportionate part of the total.

It is not difficult to see why this is the case. Take first shipbuilding. Obviously the demand for ships varies with the amount of goods and passengers needing to be carried overseas, and with the carrying capacity of the vessels engaged in the service ; and this in turn depends on the rapidity of voyages and the holding capacity of ships in proportion to gross tonnage. Let us note first of all that the modern ship, provided that it can be kept fully employed, now does more work than the ship of twenty years ago. It travels faster ; it can be turned round more rapidly at the port ; and it has a higher carrying capacity in relation to its tonnage. This serves to decrease the demand for ships in relation to the quantity of goods needing transport. But this is not the main reason for the exceptionally heavy unemployment in the shipyard trades. Suppose a trade boom occurs, and there is a sharp increase in the quantity of goods carried overseas. At once there arises a brisk demand for new ships, if it is expected that the boom will be at all prolonged. But now suppose that for some reason the total volume of trade falls off. The ships already in service will then be more than enough to carry all the goods needing transport, without any new ships at all being required. The demand for new shipping thus tends to be abnormally high in times of boom, and to fall off altogether in times of slump, except for the continued demand for vessels of quite special types such as oil-tankers. If then there is any tendency for the general volume of trade activity to fluctuate, there is bound to be a more than proportionate fluctuation in the demand for ships ; and we shall expect to

PERCENTAGES OUT OF WORK IN CERTAIN LEADING BRITISH INDUSTRIES, MARCH, 1932

Over 50 per cent.	Shipbuilding, Marine Engineering.
Over 40 per cent.	Iron and Steel Manufacture, Jute.
Over 30 per cent.	Iron Mining, Constructional Engineering, Cutlery, Public Works, Shipping, Docks.
Over 25 per cent.	Coal Mining, Pottery, Tinplates, Engineering, Ironfounding, Building.
Over 20 per cent.	Fishing, Brickmaking, Glass, Brass and Copper, Vehicle Trades, Cotton, Dying, Boots and Shoes, Woodworking, Rubber, Road Transport.
Over 15 per cent.	Chemicals, Electrical Engineering, Woollens, Silk and Art Silk, Linen, Leather, Confectionery, Food and Drink, Railways, Local Government, Hotels.
Over 10 per cent.	Hosiery, Lace, Tailoring, Bakery, Flour Milling, Paper, Printing, Public Utilities, Distribution, National Government.
Under 10 per cent.	Carpets, Dressmaking, Trams and Omnibuses, Commerce and Finance, Professional Services, Laundries.

NOTE.—Out of 2,600,000 unemployed, 312,000 were in the mining and 582,000 in the metal, engineering and shipbuilding trades. 350,000 were in building and constructing, and 260,000 in the textile industries. These industries alone thus accounted for over 1,500,000. The table very clearly shows the different incidence of unemployment on the basic industries and textiles on the one hand, and on the trades producing and distributing consumers' goods on the other.

find a shortage of shipyard workers in times of boom and a very large surplus in terms of slump.

The Demand For Capital Equipment. These conditions indeed apply not only to shipbuilding but in less degree to all the trades providing industrial equipment. When industry is booming, orders for industrial equipment rise very sharply indeed ; whereas in times of slump the existing equipment is more than enough to fulfil the current demands. Orders from the equipment trades do not indeed fall to zero ; for even in bad times factories must to some extent renew obsolete plant, and for those business men who are able to lay their hands on fresh capital a time of slump is cheapest for the purchase of new plant. But the total demand does fall off very severely, though not so much as the demand for new ships. These conditions partly account for the exceptional prevalence of unemployment in the iron and steel and engineering industries in recent years. But the position has been made more acute because these industries were exceptionally inflated during the war by the demand for munitions and therefore have been called upon heavily to reduce their personnel and their productive capacity in order to adjust themselves to the needs of the world at peace.

The demand for coal depends mainly on three things—on the general volume of industrial activity reflected in the demand for coal by the railways, by the shipping service, and by the heavy industries which use a large quantity of coal in their productive operations, on the competition between coal and other forms of fuel as the source of power, and on the economy of coal consumption. It is easy to see how all these factors have been at work in recent years to diminish the demand for the output of the coal-mining industry. There has been a great economy in fuel consumption with the improvement of boiler plant and with the greater use of electrical energy in place of steam power. There has been a greatly increased competition of oil fuel with coal, especially for ships, but also through the

use of the oil engine in productive industry, through the growth of road transport, and through the use of oil (and also of water) power in the generation of electricity. And finally there has been a decline in the demand for the products of the heavy industries which are the chief industrial users of coal and, since the world slump, in the volume of commodities requiring to be transported by sea or rail.

The coal industry has thus, despite increasing world productivity, found the demand for its output highly inelastic in the post-war years. There has been, moreover, a tendency for those countries which possess coal deposits of their own to endeavour as far as possible to dispense with imports of coal in order to adjust their trade balances. The Germans, deprived of a large part of their existing coal mines under the Peace Treaty, set out to find new sources of supply in their reduced territory, and made increasing use of lignite as well as bituminous coal. Countries such as Poland made great efforts to expand their coal exports; and in the United States there was a tremendous overdevelopment of productive capacity through the opening of new coalfields in competition with the old-established areas of supply. The world's power to produce coal is to-day greatly in excess of its needs even apart from the slump. But coal-miners are a body of men very difficult to transfer to other occupations when their services in the mines are no longer required; and, side by side with the restriction in the market for coal, there has gone a great increase in the mechanisation of the industry, especially in Germany, resulting in a very large net deplacement of labour. The miners, living largely in isolated villages in which no alternative employment is available, have found themselves left derelict by the failure of demand; and the coal problem has become in all the coalfields of both Europe and America a pressing political as well as economic issue.

The Textile Trades. In the textile trades the position is somewhat different. For there unemployment

and underemployment are due, not to a decline in total consumption or its failure to expand with the growth of the world's purchasing power, but rather to the growth of competition in the Far East, the development of the textile industries for the supply of a larger part of the home market in the United States and in a number of European countries, and the rise of artificial silk as a rival of the old-established textile manufactures. The woollen industry especially in European countries has received greatly increased tariff protection ; and this, combined with the growing industrialisation of the Far East, has reacted with exceptional severity on the highly specialised textile industries of Great Britain. Great Britain has been accustomed to export more than half her output of woollen goods and more than four-fifths of her output of cotton goods ; and in both these industries she has been the chief sufferer from the rise of competing industries in other countries in recent years.

The Building Industry. In comparison with the heavy industries and the textile trades unemployment over the rest of the industrial field was in most countries comparatively light until the onset of the world slump, which caused a great increase in almost every industry. The only other industry to which reference need be made at this stage is building. The demand for the products of the building industry consists partly of the demand for industrial buildings, shops and offices as well as for public institutions of various kinds, such as schools, and partly of the demand for housing accommodation. The industrial demand for factory buildings naturally fluctuates much in the same way as the demand for machinery and other forms of industrial equipment, while the demand for shops and offices depends on the general level of trading activity. In the case of public buildings demand tends to fluctuate in accordance with the budgetary condition of the national and local authorities in the various countries. If they feel rich they order large numbers of new schools, town halls and

other public buildings; whereas any economy campaign directed to the cutting down of public expenditure is certain to react most formidably on this type of demand. Houses are in the modern world supplied partly by private and partly by public agencies. Where they are supplied by the State or by the municipality, or with some form of aid from public funds, the number built will tend to fluctuate in much the same way as the number of schools and public buildings, in accordance with the budgetary position.

Private housebuilding, on the other hand, depends on the level of costs in the building industry in relation to the purchasing power of the public, but is also affected by the level of rents charged for existing houses. During the war housebuilding was largely suspended in European countries, and this caused in most of them the enactment of special measures of rent restriction in order to prevent the exaction of monopoly prices by owners of existing houses. As the housing shortage has never been overcome, these restrictions have had to be continued; and they have militated against the renewal of private building by setting a level of rents, especially for the smaller dwellings, that has been out of proportion to the costs of new building. This has made it necessary for States and municipalities to subsidise housebuilding either directly or through co-operative housing associations on an extensive scale; and the activity of the building industry as a whole has thus come to be influenced far more than before the war by budgetary conditions. Hence, despite the shortage of housing accommodation, the great decline of building activity in most countries since the slump of 1929; for the falling off in the demand for industrial and commercial buildings and public institutions has coincided with the restriction of public expenditure on housing schemes.

So much for the broad facts of the distribution of unemployment among the workers in different trades and occupations. It will be seen that in times of slump unemployment tends to be most severe in the constructional trades, in industries, such as coalmining, which depend largely

upon them and on the general volume of industrial activity, and in the building industry. The heavy unemployment in the textile trades during the present slump is due to peculiar causes and is not in accordance with the experience of previous world depressions. The industries producing consumption goods and rendering services, such as public utilities, usually suffer a good deal less from unemployment than the basic trades ; and this has been on the whole the case during the present depression although, especially in America, the extreme severity of the present slump has reacted on some branches of the consumption trades and on distribution hardly less heavily than on the basic industries.

Unemployment Among Young and Old. Unemployment tends also to be very unevenly distributed among workers of different types and ages. How it reacts on men and women respectively depends mainly on the industries which it chiefly affects. The constructional trades employ a very high proportion of men ; and most slumps therefore tend to react more heavily on employment among men than among women. But the textile trades employ a great majority of women, and in such areas as Lancashire and Yorkshire women's unemployment has been a very marked feature of the present slump. Of far more significance is the incidence of unemployment on workers of different ages. There is usually little unemployment among juveniles, whose labour is relatively cheap and therefore tends to be used to an increasing extent in bad times ; but there is a marked tendency for juveniles to be thrown out of work as their wages approach the adult standard. This is a very serious matter because adolescents are in this way deprived of the chance of learning a trade and getting into habits of regular industry just at the critical time of their lives. Unemployment is exceptionally disastrous for the adolescent worker, and may undermine his productive capacity for the rest of his life unless proper measures are taken to keep him in good trim

through the provision of training and educational facilities.

Unemployment, however, occurs far most severely among the older workers. Every country which compiles unemployment statistics records a considerably higher percentage of unemployment among workers over forty than among the younger age groups. Especially where the demand for labour is cut down by rationalisation or the introduction of new machines, the older workers are usually the first to be dispensed with ; and there is a growing tendency, as the pace of industry is speeded up, to prefer younger men and women both because they can more easily stand the hot pace and because they are more adaptable to new industrial processes than those who have long been accustomed to a traditional method of carrying on a trade. It follows that, when older men or women are thrown out of work, it is far harder for them to find new jobs ; and accordingly their spells of unemployment tend to be far more prolonged than those of younger workers. Indeed, for a good many of the older workers thrown on the industrial scrapheap by rationalisation or the contraction of the industries in which they have been employed there is hardly any hope at all of finding fresh work. All countries which have unemployment insurance schemes find the financial strain upon their unemployment funds greatly swollen by the claims to benefit of these older workers ; for, even where some scheme of old age pensions is in force, the worker is liable to be flung out of industry long before he reaches the pensionable age. All unemployment insurance schemes ought to be reformed so as to take the charge of maintaining these older and largely unemployable workers off the funds subscribed to by employers and workers, and to make their maintenance a direct charge on the State. For there can be no doubt that the development of industrial technique is likely to put an increasing premium on youth as a qualification for employment ; and no unemployment insurance scheme can be expected to work satisfactorily if it is also being used as a pension scheme for unemployables.

It has often been suggested that, when industries throw

their older workers on the scrapheap, they, and not the State, ought to incur the charge of maintaining them. This is very right and proper where the industry is prosperous and developing. But unfortunately the tendency to throw out the older workers is strongest where the greatest contraction of labour is taking place ; and this is mainly in industries which are already in severe financial difficulties and certainly not in a position to stand additional burdens. It would be useless to call upon the cotton trade of Lancashire or the coal mining industry in any country to maintain the large number of workers who are being discarded ; and in one way or another the burden of maintaining these workers must be spread over the community as a whole. It would be far better to do this by general taxation than by an illegitimate charge on funds subscribed for the quite different purpose of unemployment insurance.

Apart from these older workers and a certain number of others who, on account of some physical or mental disability, are at the best of times near the margin of employability, the great mass of the unemployment in all countries consists not of a stagnant body of continually workless men and women, but of a constantly shifting section of the employable population. The majority of the workers who are at any time registering at the employment exchanges or seeking work consists of persons who have been in some sort of a job not long before, and are reasonably likely before long to find some sort of a job again. This is true even to-day at the bottom of the slump ; and it was true of a far higher proportion of the unemployed up to 1929. But, although a comparatively small proportion of the unemployed have been continuously out of work for a very long period at a stretch, this does not mean that the available amount of employment is fairly evenly shared out among the greater part of the industrial population. For a considerable proportion of those who have had some work have had very little—just a casual job every now and then, which has taken them off the books of the exchanges or out of the bread queues for a few weeks. A large section of the industrial

population is practically not liable to unemployment at all. It consists of a permanent body of workers in industries comparatively immune from industrial fluctuations, such as the Post Office or the leading public utility services, and of a nucleus of workers who hold practically permanent jobs even in industries in which a considerable amount of fluctuation exists. Doubtless these permanently employed workers include a high proportion of the more efficient operatives, and the liability to unemployment tends to be greatest among the less efficient. But this generalisation must not be pushed too far ; for liability to unemployment is also largely a question of fortune, varying from occupation to occupation, and a worker who has once found himself without work for a considerable period is very liable to have his physical and technical efficiency impaired, and thus to become less employable as a result of his enforced idleness. Unemployment insurance has been devised, not only as a recognition of public responsibility for the maintenance of those who can find no work, but also as a means of preventing the industrial deterioration which arises from long spells of unemployment in the absence of an income adequate to afford a satisfactory physical standard of life. That is why, if the slump is prolonged, even the United States, despite its strong hostility to public provision, is bound to be driven into some form of organised public action for the maintenance of the unemployed.

§2. THE BURDEN OF UNEMPLOYMENT

UNEMPLOYMENT is, of course, no new trouble of post-war times. It existed long before the Industrial Revolution ; and it has existed throughout the history of the capitalist system. Since records of the number of unemployed began to be compiled, first by trade unions which provided unemployment benefits for their members, there has never been a time at which there were not in the

aggregate a considerable number of workers out of a job. Broadly speaking, even in prosperous times it seems as if the proportion of workers unemployed has practically never fallen below about two per cent, although during the War it was reduced considerably below this proportion. In Great Britain between 1850 and 1914 the percentage of workers unemployed varied between about two per cent at times of the greatest prosperity and about twelve per cent at the bottom of the deepest trade depressions. The average level was somewhere about five per cent. These figures, based for the greater part of the period exclusively upon a limited number of trade union returns, cannot, of course, be taken without question as reflecting the general volume of unemployment in the country ; but on the whole their evidence seems to be confirmed by the more elaborate records collected since the institution of unemployment insurance over a limited field in 1911. It is impossible to say whether these percentages would apply broadly to other countries in the absence of comparable records. But at any rate the amplitude of pre-war fluctuations is probably fairly well represented by the difference between two and twelve per cent.

When the percentage of workers unemployed is at or near the minimum, obviously the greater part of the unemployment that remains arises simply out of friction in the working of the industrial system. Most of it exists because of the intervals involved in changing from job to job ; and the only instances of prolonged unemployment at such times are either in decaying trades or in the case of workers who are near the margin of employability. Unemployment on this scale does not constitute a serious social problem. But when unemployment rises above, say, five per cent its effect begins to be serious ; for the spells of unemployment then tend to become longer, and it is harder for the workers to tide over the period between jobs by living on their accumulated resources. It is at this point that the necessity for public provision arises ; for although, before the days of unemployment insurance, trade unions did something to

provide out of work benefits for their members, only the unions of relatively skilled and highly paid workers were able to afford this provision, and the social effects of unemployment therefore fell with exceptional severity on the less skilled who were least able to bear them.

Unemployment Insurance. Unemployment insurance, when it came in Great Britain and Germany and certain other countries, brought an inestimable social relief to the victims of trade depression ; but the prolonged and extensive unemployment of the post-war period knocked the bottom out of the financial estimates on which the earlier schemes of unemployment insurance were based. These schemes had been meant to deal with unemployment of the pre-war type, fluctuating between a minimum of about two per cent and a maximum six times as great as this, and keeping up an average level of not more than five or six per cent year in and year out. But they had to face, in the years after the war, unemployment on a very much greater scale than this ; and accordingly the contributions provided by workmen, employers and State soon proved hopelessly inadequate to maintain the promised rates of benefit. It then became necessary to find additional funds from some source. There were several possibilities. The first was that of increasing the contributions levied upon the employers and workmen, with or without a proportionate increase of the State's share. A second possible course was for the State to provide the additional resources required out of the proceeds of general taxation. The third was for the Unemployment Insurance Fund to be allowed to borrow from the State in order to meet its exceptional obligations, with the idea that repayment would be made on the return of better times. In fact, all these methods were employed in varying degrees in different countries. Germany went furthest in raising the rates of contribution from employers and workers ; while Great Britain for a long while relied mainly on the method of borrowing, even after it had become obvious that there was little or no chance of the sums

borrowed being repaid. But finally both these methods broke down, and it became inevitable for the State to take upon itself directly and without any pretence of insurance the maintenance of a substantial proportion of the unemployed. Those who were experiencing short spells of unemployment were left to receive their contractual benefits under the insurance system, while the State in one way or another assumed the burden of maintaining those who had exhausted by prolonged unemployment their limited contractual rights to benefit. In both Great Britain and Germany the total cost of providing for the unemployed rose to very great heights ; and this led to constant allegations that the schemes were being misused and benefits being paid to large classes of persons who were not really seeking work. Such cases doubtless existed ; but investigations failed to prove the presence of widespread abuses, and the attempts to achieve economy by withdrawing benefit from particular classes of workers who appeared to have no adequate claim resulted only in small savings.

Accordingly, in pursuit of economy, States resorted to other methods. The basis of unemployment insurance was that a man paid contributions at certain fixed rates—either at a flat rate as in England, or at rates varying with the amount of wages received as in Germany—and got benefits also at fixed rates—either uniform as in Great Britain or varying with contributions as in Germany—in return. When benefits had to be paid in cases of prolonged unemployment beyond the limited period originally allowed under the schemes, the extended benefit was usually granted at the same rates as the contractual benefit payable under the original scheme. But the new method adopted in the interests of "economy" was to make a sharp differentiation between contractual and non-contractual payments. To those who had not exhausted their contractual claims benefit continued to be paid at the standard rates ; but for those who had been long out of work the new system of a "means test" was instituted. In other words, they received, not benefits at a standard rate, but only such allowances

as they were deemed by a local committee or tribunal to need for mere subsistence. Furthermore, workers subject to the " means test " could be compelled to use up their savings before their claims to benefit could be recognised. In this way the sums spent on the unemployed were considerably cut down ; but even so the cost of unemployment insurance in the years following 1929 remained heavy enough to constitute a severe drain on the budgetary resources of the countries in which the system was in force. Nevertheless public opinion in these countries, however ready it might be to scent abuses in the working of the various schemes, remained solidly in favour of the maintenance of the unemployment insurance system, which was regarded not only as an indispensable recognition of the public obligation to maintain those who could find no work, but also as a valuable insurance against revolution.

It has, however, become perfectly plain that no unemployment insurance scheme can stand the strain of unemployment on the scale on which it has existed year after year since the war, and still remain really insurance at all. Inevitably it comes to be a form of public provision for the maintenance of large bodies of workers for whom the economic system is unable to provide jobs. This necessity indicates a profound difference between pre-war and post-war unemployment, in that pre-war unemployment, even at the worst of times, remained within limits which were capable of being provided for by something like insurance. Moreover, these bad times were never in pre-war days prolonged year after year ; and the return of good times brought with it a cessation of unemployment on any significant scale save in casual and seasonal trades.

There was in those days nothing in the nature of a permanent surplus of labour, unemployed even when trade was good. But in the post-war world even the relatively good years between 1924 and 1929 failed to bring unemployment down to a tolerable level. In Great Britain the numbers out of work never fell below a million through all these years.

This undoubtably happened to a great extent because of

the effects of mechanisation in throwing workers out of employment faster than the development of industry was able to provide them with new jobs. The economic system was showing itself more and more unable to find means of using all the productive resources at its command, even before the world slump came to aggravate further the disproportion between productive capacity and consuming power. There was, nevertheless in the minds of most people after the war a strong reluctance to recognise that there had been a fundamental change in the character of the unemployment problem. The hope continued to be entertained that, as industry developed, it would find means of reabsorbing all those whom it had flung out ; and men turned a blind eye to the effects of rationalisation in displacing labour more and more rapidly in the great basic industries.

§3. THE "TRADE CYCLE"

THIS ATTITUDE was maintained even in the face of the world slump of 1929. It was confidently asserted that this slump was only a repetition of the long familiar phenomenon of the trade cycle. Trade, it was said, had been on the up-grade between 1924 and 1929; and now it had entered upon one of those periodic crises that had marked the entire course of the previous century. The length and intensity of the slump were likely, as in previous cases, to be commensurate with the magnitude of the previous advance. But no doubt was felt that this slump, like other slumps before it, would in due course automatically come to an end, and give place to a fresh forward movement. Economists drew graphs to show how long the slump was likely to last, and how bad it was likely to be, on the analogy of previous depressions ; and there was a general reluctance to attempt any preventive action because, in pursuance of the theory of the trade cycle, the slump was regarded as something inevitable and curable only by the lapse of time.

But the experience of the past three years has served to

make many even of the staunchest upholders of the theory of the trade cycle doubtful of the soundness of this view. For the slump, on the analogy of previous slumps, ought by now to be showing clear signs of lifting ; and already its extent and the dislocation which it has caused have far exceeded anything which has resulted from previous depressions of trade. But the theory of the trade cycle, as the automatic and incorrigible accompaniment of modern business enterprise, dies hard. For my part I have never believed in this theory at all. I do not believe that there is, or that there ever has been, such a thing as the trade cycle. But as this view is still regarded as wildly heretical among the majority of economists, it is necessary to say something of the theory of trade cycles as it is stated in orthodox economic circles.

This theory is, broadly speaking, that trade and industry alternate between prosperity and depression with a definite rhythm based on the internal working of the economic system itself. It is possible to begin the description of this alleged cyclical movement at any point of the cycle. But it is commonest to start the description at a point when trade and industry are slowly improving after a previous spell of depression. This improvement, it is pointed out, has certain inevitable consequences within the present constitution of the economic world. Above all, as demand improves, prices tend to rise ; and manufacturers are able to sell their goods on better terms. Their costs, however, do not rise in proportion to the increase in their takings ; for certain elements in costs lag behind the general rise in the price level. These lagging costs include, in the first place, rents and interest on money which has been borrowed on contractual terms for a considerable period, and secondly and above all wages. For it takes some time before existing wage agreements expire and before workers are able to use the improved bargaining power which increased employment brings with it so as to get their wages raised in proportion to the rising price level. In the interval the margin between costs and selling prices is increased, with the result that the employers

make larger profits. These larger profits exercise a double influence. In the first place, the prospect of profits at a satisfactory level tempts those who have capital at their disposal to invest it in new productive enterprise; and secondly there is more capital available because, when profits increase and wages remain relatively low in purchasing power, the community is likely to save a high proportion of its total income. There thus arises a period of active investment, resulting in great activity in the constructional trades and a considerable increase in the potential productivity of the business world.

But these developments can be financed only with the aid of extended credit from the banks; for expanding business not only requires a larger supply of long-term capital for its development but also more abundant short-term loans. For a time the bankers readily satisfy these demands by the creation of additional credits; but in due course, as prices continue to rise, the situation begins to change. The wage-earners press their demands for higher remuneration. Less efficient plant and labour are pressed into the service of production; and capital in search of profitable enterprises to finance, having exhausted all the more favourable opportunities, turns to forms of enterprise which promise in reality only a small return, even if they are not likely to be utterly unremunerative. Costs of production thus tend to rise again in relation to selling prices; and a point is reached at which the bankers are reluctant or even unable to create further credits because they have arrived at the limits set by their cash reserves and by the supply of currency that the Central Bank is allowed to issue. Moreover, they become apprehensive about the future, and begin to scrutinise more closely the long-run prospects of the enterprises in respect of which their customers are seeking accommodation.

At this stage what commonly happens is that the Central Bank sharply raises the rate of discount as a danger signal to the financial world as a whole. Even if the consequent rise in interest rates does not directly choke off borrowers—as it may not if confidence in the business world is strong—

the joint stock banks nevertheless take warning, and proceed to refuse further credits and gradually to contract their existing obligations. The rise in interest rates further raises costs, and narrows the margin between costs and selling prices. The withdrawal of bank advances compels manufacturers to decrease production. Workers are flung out of work, profits begin to fall, and both the power and the willingness to buy are at once impaired. For even those who can buy are reluctant to do so if they think a turning point has been reached, and the future course of prices is likely to be downward. There ensues therefore a period of business depression as the direct consequence of the contraction of bank credit ; but this, the bankers say, is not their doing, but the inevitable result of the pushing too far and too fast of the preceding boom.

This change from boom to depression may be accomplished with or without a serious business crisis. It has often been argued that, if the banks would only restrict credit sooner than they have usually done, and so prevent prosperity from developing into boom, the amplitude of the ensuing depression might be greatly diminished, and the occurrence of a crisis actually prevented. But in fact the bankers generally wait before contracting credit until a boom is in full swing, and then contract it suddenly and drastically, with the result that the business world, suddenly deprived of the accommodation to which it has been used, and made aware that the boom is at an end, reacts from extreme confidence to extreme distrust and, by an orgy of liquidation and a widespread refusal to buy, makes the slump far worse than it need be if people were able to keep their heads. Be this as it may, with or without a crisis, boom passes into depression ; and for a time depression continues to deepen.

But, according to the theory of the economists, this depression cannot in the nature of things be indefinitely prolonged. It is marked everywhere by an extreme reluctance to buy goods and by a sharp curtailment both of production by the producers and still more of stocks by the

wholesalers and retailers, who allow their supplies of goods to run down in the hope of renewing them at lower prices. But this widespread abstention from buying, with its reactions on the volume of production, ultimately brings its own corrective. Stocks run down to such a point that they have to be replenished in order to meet even the restricted demand. Buying starts again, and production responds to the increase in orders. As soon as business men realise that the tide has begun to turn, they become as eager as they were previously reluctant to buy. For now their fear is that any delay will result in their having to buy at higher prices. Traders accordingly begin again to pile up stocks beyond their immediate requirements ; and the increased orders which are forthcoming from this source give a proportionately favourable stimulus to the revival of production. Workers are brought back into employment, and borrowing from the banks is renewed. The volume of purchasing power thus begins again to increase ; and the upward phase of the business cycle is reached once again.

The Psychological Explanation. With this broad description of the superficial character of the business cycle most economists would agree. But they would differ considerably in the explanations of the phenomena which they would offer. One school of thought, for example, holds that the underlying causes of the business cycle are mainly psychological, and that it is due to alternating errors of over-confidence and under-confidence in the business world. Business men, it is pointed out, are highly suggestible, and greatly dominated by the herd instinct. Confidence felt in one part of the business world tends to spread over the whole system ; and confidence tends to breed further confidence far beyond the point at which increasing confidence is legitimate. Thus every upward movement of the cycle tends to be carried too far and to reach a point at which enterprises not really justifiable by the prospects of an economic return are undertaken, usually to the accompaniment of large speculative movements on the stock and produce

exchanges. Similarly pessimism breeds pessimism ; and, when over-confidence has brought its nemesis in the beginnings of a slump, the business world tends to pass to the opposite extreme of mistrust. Gradually this mistrust wears off, leaving room for a revival of confidence and a gradual return of prosperity.

This psychological explanation of the trade cycle was much in favour among economists a dozen years ago ; but I think hardly anyone holds to it now—at any rate as the main explanation of industrial fluctuations. It is, of course, perfectly true that the business world is very suggestible, and that errors of over-confidence and pessimism are constantly occurring and produce very significant consequences upon business activity. But, after all, both confidence and pessimism are reactions of men's minds to objective facts ; and it is highly paradoxical to treat the mental reactions and not the objective facts which they reflect or distort as the underlying causes of industrial progress or recession.

The Monetary Explanation. A second explanation which has found favour in the past interprets the business cycle almost exclusively in monetary terms. It is pointed out that the change from boom to depression is almost always heralded by a sharp contraction of bank credit and a raising of the rate of discount by the Central Bank ; and it is held that this stringency of money is the actual cause of the crisis and the ensuing depression. It seems to be suggested that, if the bankers would but go on creating money indefinitely as long as further productive resources are available for use, there would be no reason why prosperity should ever cease. It may of course be admitted that, if productive resources are already fully employed and additional funds can be used only for the purposes of speculation, there is no case for a further expansion of bank credit. But it seems to be argued that, if bankers could find means, as they have not yet done, of restricting speculation without checking productive enterprise, they would have

it in their power to prevent crises or business recession from ever arising at all.

It is doubtless highly natural that business men, whose difficulties in time of crisis arise first in the form of a raising of interest rates and a restriction of credits by the banks, should take this view. They have, so they think, remunerative additional business in prospect; and it seems to them that the banks, by refusing them accommodation or at any rate charging higher rates for it, are wantonly standing in the way of industrial progress. It may be admitted that under the existing laws of most countries there are statutory limits to the power of the banking system to increase the supply of currency, and that these restrictions impose limits also on the supply of credit—since additional bank credit necessarily creates some demand for additional currency as well. But those who explain the trade cycle in purely monetary terms usually argue in addition that the limitations on the creation of currency ought to be removed in order to enable credit to be expanded as long as there are legitimate demands for it for productive uses.

There are, however, two serious objections to any theory conceived in these terms. In the first place, the result of the expansion of credit beyond a certain point is bound to be a rise in prices. This, indeed, will only happen if the expansion of credit fails to cause a proportionate increase in the supply of goods and services. But at the height of a boom all the most productive resources, both human and material, are likely to be already in full use; and the extra credits are accordingly not likely to be used as productively as those previously supplied. Prices, therefore, will probably rise; and, if one country pursues the policy of credit expansion so far as to cause a rise in its price level without other countries doing the same, the result will be to impair its competitive capacity in world trade, to stimulate imports and to hamper exports, and thereby to set up either a drain of gold, if the country in question is on the gold standard, or a fall in the external value of its currency if it is not. It is difficult in these circumstances for one country to

push a policy of trade expansion further than its leading competitors ; and, even if this international difficulty is left out of account, the effect of such an expansion of credit as seriously to raise the price level would be to set in motion forces which would alter the distribution of incomes in the community for the worse, and perhaps pave the way to uncontrolled inflation.

But there is a more fundamental reason why the purely monetary explanation of the trade cycle cannot be accepted. For the bankers themselves have certainly no interest in restricting credit except for some reason which they believe to be valid. The more credit they are able to create the more profit they will be able to make ; and in restricting credit they are actuated by their observation of what is happening in the business world as a whole. They restrict the supply of money because they believe that the over-confidence of business men is inducing them to embark upon productive projects which are unlikely to yield an economic return. The bankers are interpreters, although they may be incorrect interpreters, of the objective phenomena of the business world as a whole. They are not the originators of these phenomena. While therefore an unwise banking policy may and does greatly aggravate industrial fluctuations, it is impossible to uphold the view that these fluctuations are solely due to the malignant and inexcusable behaviour of the financial world in refusing producers the accommodation which they desire.

The monetary explanation of the trade cycle, however, sometimes takes a different form, in which the blame is put not upon the bankers so much as upon the system which the bankers blindly administer. In this form the trade cycle is regarded as the outcome of price movements which in turn depend on the adequacy of the world supply of gold. It is pointed out that in the course of the last century upward movements in the general level of prices have usually coincided with an increase in the quantity of fresh gold passing into the world's monetary supply ; while the price level has tended to fall when the annual increase in the

supply of gold has lagged behind the corresponding increase in the world's production of goods and services. Professor Cassel, in a memorandum presented to the Gold Delegation of the Financial Committee of the League of Nations, has argued strongly in favour of this view. We have seen in a previous section how, under the gold standard, the price level is influenced by the relation between the supply of currency, which depends ultimately upon the supply of gold, and the volume of transactions needing to be financed by means of currency. We there saw that it was true to suggest that an enlargement in the supply of gold would tend to raise prices and a contraction to lower them, subject of course, to the reservation that the distribution of the available gold, as well as its total amount, may affect the volume of currency based upon it. But trade depression is closely associated with falling and trade prosperity with rising prices. If then movements in the price level are primarily due to changes in the supply of gold available for monetary uses, is it not plausible to argue that these changes are underlying causes of fluctuations in economic prosperity?

This view is attractive ; but it is not tenable. The level of world prices fell almost steadily from the middle 'seventies to the middle 'nineties of the last century; but it is fantastic to describe this period of twenty years as a period of world depression of trade. It was indeed a period in the course of which there occurred several serious trade depressions—those of the later 'seventies and the middle 'eighties and of the early 'nineties. But taken as a whole the period was one of extraordinarily rapid advance in world prosperity and in the world standard of life—probably of even more rapid advance than the following twenty years, during which the tendency of the world price level was upward. It is true that in times of business depression prices tend to fall, and that in times of prosperity they tend to rise. But it is impossible to identify these short-term oscillations in prices with the long-term upward or downward tendency of the price level in consequence of variations in the world supply of gold. A fall in prices will not serve to depress trade unless prices are falling

more rapidly than world productivity is increasing ; and it is quite possible, if productivity is advancing fast, for a falling price level to co-exist with highly prosperous conditions in industry and commerce.

The purely monetary explanation of trade fluctuations must therefore be discarded no less than the purely psychological explanation—although it can be admitted that monetary phenomena have a most important effect in aggravating or reducing the amplitude of fluctuations due to more fundamental causes.

§4. WHY TRADE FLUCTUATES

THE OTHER explanation of trade fluctuations which has the largest following is particularly associated with the name of Mr. J. A. Hobson, but owes much to the earlier diagnosis of Karl Marx in the second volume of *Das Kapital*. Mr. Hobson's theory fastens on the effect of improving trade conditions in widening the margin between costs and prices, so as to increase business profits without a corresponding rise in the wage level or in the purchasing power of the great mass of consumers. This rise in business profits, as we have seen, tends to stimulate investment, and to cause great activity in the constructional trades. But this investment can be justified in its economic results only if there exists a sufficient market to carry off the increased supply of consumers' goods which the new factories are designed to produce. This, Mr. Hobson suggests, cannot happen under the existing system because of the tendency of wages to lag behind profits, and of those who receive the profits to spend too little of them on consumable goods and too much in the purchase of fresh instruments of production. The result is a relative "oversaving" in the community in times of business prosperity ; and this relative "oversaving" is bound to bring disaster with it because, in face of the restricted consumers' demand, the new factories will either be unable to produce at a profit themselves, or by their

competition will drive existing and less efficient factories out of business. Workers will then be dismissed and consuming power still further contracted ; and this will happen all the more because the new factories will probably be more highly mechanised than the old, and will tend to produce the same quantities of goods with the aid of a smaller amount of labour.

As the deficiency of consumers' demand becomes manifest this will react first of all through increasing competition on the ability of the less efficient concerns to carry on, and later on the costs even of the more efficient concerns, which will not be able to keep their plants fully employed. A business recession will then ensue, involving many bankruptcies and a great writing-off of capital assets, until the volume of productive capacity has been brought down to a level with the reduced consumers' demand. When enough plants have been driven out of business and dismantled to produce a new equilibrium a slow resumption of business activity will again become possible, and industry will proceed towards a new phase of prosperity destined to lead to a recurrence of the same disaster.

Of all the estimations of the trade cycle this one, I think, embodies the largest amount of truth. It is conceived in objective terms, and its central thesis is undeniable. Factories and instruments of production are of use or value only in as far as they can be employed in producing goods for which there is an effective demand. The attempt to divert purchasing power from the making of consumers' goods to to the creation of additional instruments of production is therefore bound to be disastrous if it passes the appropriate point ; and Mr. Hobson has shown that there is a reason why in the modern community it should tend to pass this point—this reason being the admitted lagging of wages behind profits in times of increasing business prosperity.

Why Do Slumps End? But even this explanation cannot be regarded as wholly adequate. For, if we look back at the booms and depressions of the past century without any

preconceived theory in our minds, we shall find that they are, one and all, susceptible of explanation of terms of special causes peculiar to each. Doubtless the operation of these special causes has in all cases been aggravated by psychological and monetary factors, and by the failure to strike the right balance between consumption and investment. But neither Mr. Hobson's theory nor any of the others is really able to explain satisfactorily why, when a slump has once occurred, it ever comes to an end. Mr. Hobson, unlike the psychological and monetary theorists, does, I think, explain satisfactorily why booms end in disaster ; but any theory of the trade cycle that is to be recognised as valid must explain why slumps end as well.

And yet—should not progress and advance in material prosperity be the natural accompaniment of human economic activity ? All the time, man's command over nature and his power to produce material wealth are increasing over the greater part of the world very much faster than population. Surely, it may be said, there is no need for any further explanation of the ending of a slump than that the forces which have brought it about gradually exhaust their strength, leaving the normal progress of economic activity to be resumed without hindrance.

There is some truth in this view ; but it must not be forgotten that, even if the normal tendency of economic life is progressive, nevertheless when once a slump has set in it tends to set in motion artificial causes which deepen and deepen the depression of trade. The more prices fall owing to the failure of demand, the more demand continues to be depressed, so as to force prices down still further. The more pessimistic men feel, the more reason have they for their pessimism. The more nervous banks get about making advances to their customers, the more likely is it that the making of advances will turn out to be unsound. Depression breeds depression ; and the familiar explanation that the exhaustion of stocks must lead in due time to a recovery seem wholly to fail to account for the bringing of any major depression to a close. For, under modern conditions at

least, are stocks ever likely to be exhausted, even if current production is most severely curtailed? There is little evidence in the figures of the past few years of any approach towards a reduction—let alone an exhaustion—of the stocks of many primary commodities which were allowed to accumulate during the early days of the slump. The world is indeed at last beginning to trench upon its stock of wheat; but almost nothing has yet been done to bring stocks of raw materials down to a level which promises an early revival of prices.

This, it may be said, is because the world is economically more organised now than it used to be: so that the power of combines to hold stocks is greater, and the holding of these stocks off the market allows current production to go on at a higher level than it could do if stocks were not being withheld. Thus, it is argued, the attempt to stave off depression by the organised holding of stocks has actually served to make depression longer and more intense and to prevent the necessary corrective forces from coming into operation. But even when allowance is made for this suggestion it seems very doubtful whether the gradual exhaustion of the stocks would be likely in itself to reach such a point to give an impetus sufficient to bring about the revival of trade, however long a depression might last. There is more to be said for the view that trade depressions end because of the reversal of banking policy. For the bankers, having allowed their loans to be reduced to a very low level in consequence of the slump, find themselves with large idle resources on their hands; and these resources are swollen by the refusal of the public to invest its money in business enterprise under the threat of loss and its preference for leaving it unused in the banks, where it is hoped that it will at any rate be kept safely until better times return. The pressure of idle bank deposits, it is suggested, finally leads bankers to grant advances on a more liberal scale; and the new money put into circulation by the increase of bank advances causes enough rise in prices to give the necessary impetus to the revival of trade.

What Can Bankers Do? It is true that in times of depression the power of the banks to create fresh money by the making of advances is very limited; for they cannot compel borrowers to borrow unless the borrowers see some prospect of using loans to commercial advantage. The policy of cheap money may fail because the cheap money is not taken up; and, even if the Central Bank attempts to pump more money into circulation by buying securities, the money which it pays out for these securities may be simply placed on deposit in the banks, and thus be returned to it without any effect on the amount of money in active use. It is, therefore, not within the power of the banks merely by the creation of credit to bring about a revival of trade in face of conditions of severe depression. They can only take advantage—or fail to take advantage—of a favourable opportunity when it presents itself. The failure of the banks to expand credit when their chance comes may postpone indefinitely the occurrence of a revival of trade; but they can act only upon the opportunities presented to them by the objective situation and not independently of that situation.

Mr. Hobson would probably suggest that under his theory the reason why slumps come to an end is that in times of depression wages and profits show an opposite tendency to that which marks their course in times of prosperity. For wage-rates are usually reduced more slowly than prices, whereas profits fall most heavily of all, since the profit taker is, as we have seen in an earlier chapter, the residuary legatee of the process of production. Thus, whereas in times of prosperity modern communities tend to invest too much and to spend too little, in times of depression investment tends to be damped down much more than spending, until the balance is tipped the other way, and the failure to expand productive resources begins to offer really favourable opportunities to the investor who is prepared to risk his money. But this view, while it has some truth in it, seems to take too little account of two important factors. In the first place, a community can carry on in times of depression

practically without fresh investment, and yet for a long time find its productive resources based on past investment in excess of its current consuming power. There is no sign in the world to-day of a deficiency in productive resources to create all the goods that the world is at present able to buy. If we wait for " under-investment " of itself to bring about a trade revival, we shall indeed have to wait a very long time.

In the second place, while in times of slump wage-rates are reduced as a rule more slowly than prices, the fall in wage-rates by no means adequately reflects the fall in the total wages bill. For, apart from the changes in wage-rates, total earnings are greatly reduced by unemployment and underemployment ; and it is the size of the total wages bill, and not the level of wage-rates, that determines the consuming power of the working class. During the present slump in the United States the figures of total earnings show a very much heavier decline than those of the numbers of workers in employment or those of the standard rates of wages. In Great Britain and other countries possessing schemes of unemployment insurance this tendency for the total purchasing power of the workers to fall is to some extent counteracted by the transference of income through taxation from the rich to the poor; and in such a situation the balance between spending and investment is likely to be redressed. But in the United States, in as far as the balance is in any degree redressed this arises much less from any increase in the share of the current national income passing to the working class than from a positive investors' strike, which results in a substantial part of the income of the rich not being used at all by way of either spending or investment. This redressing of the balance is doubtless, from whatever causes it comes, a factor in enabling slumps to be brought to an end ; but it is by itself a wholly insufficient explanation of their ending.

I suggest then, that slumps end and prosperity returns partly because economic progress is the normal condition of the modern business world, but also partly because either

some fortunate event or some policy deliberately pursued suffices to correct the tendencies making for depression and to bring about a revival. In other words, revival is not automatic, however long a slump may last. Men have either to wait for some definite event or series of events to bring about a revival without any positive effort on their part, or revival has to be definitely engineered by conscious planning.

The great revivals of the past are all associated with fortunate events that have sufficed to overcome the accumulative tendencies of trade depressions. Such factors as fresh discoveries of gold, the opening up of undeveloped areas, the sudden expansion of demand in some particular market —as for example in the German market of 1870,—the rapid exploitation of some new epoch-making discovery which has offered large prospects of profit to those who were first in the field—these and similar causes have sufficed in the past to rescue the business world from repeated depressions into which the working of the economic system has plunged it. The question is whether, in the present slump, we can rely on some similar good fortune to bring the world out of its economic prostration, or whether we have now to substitute the conscious planning of recovery for a mere waiting on events.

§5. THE PRESENT SLUMP

THE PRESENT slump is more severe than any of its predecessors, not only in the depth of the industrial depression which it has caused or in its extension over all countries, but also in the degree of disturbance which it has set up in the public finances of the various countries and in the equilibrium of international relationships. The normal business slump brings bankruptcy to many producers and traders ; but no previous slump has threatened a large number of the world's Governments with national bankruptcy and complete economic and political collapse. This fact gives the present slump a character unlike any of its predecessors,

and renders it much more difficult for any mere chance event, or even any deliberate action taken within a single country, to set the world on the path towards recovery.

This political character of the present slump, involving Governments fully as much as private capitalists, is obviously due in the main to three things. In the first place, it is due to the legacy of national and international indebtedness left behind by the war ; in the second place to the precarious attempts at reconstruction in Europe with the aid of foreign capital ; and thirdly to the sharp fall in prices which has swollen beyond all bearing the debts incurred during and after the war. This vast burden of debt would have been difficult enough to bear even if its real weight had not been enormously increased by the fall in prices ; but the increase in its commodity value has made it plainly past the world's endurance. Accordingly the first step towards the world's revival must clearly be the relieving of Governments from obligations which they cannot hope to fulfil by large-scale cancellation or reduction of debts, in order to re-establish the solvency of national economic systems, and thereby provide firm foundations for the rebuilding of national industries. If this does not come by way of international agreement, it is bound to come in the form of national repudiation ; and if the creditor countries endeavour to obstruct its coming in one or other of these ways it will come none the less, but will come in that event by way of world revolution.

Let us suppose that the world's Governments have had enough sense to understand this situation, and that debt burdens have been reduced within manageable proportions. This by itself would certainly not avail to bring about world revival, although it would create conditions of confidence which would make revival far easier to stimulate. What would be the next positive steps ? They would be to some extent national, and to come extent also matters of international agreement. Among the international matters the most important would be a reduction of tariff barriers and wherever possible a widening of free trade areas, combined

with agreements between countries for the mutual exchange of products. Side by side with this removal of barriers would have to go large measures of disarmament, designed both to liberate funds for constructive economic tasks and to create the right atmosphere both for the renewal of freer international economic intercourse and for a revival of investment. But these international measures would have to be accompanied by national measures designed to stimulate employment and production within each country. As we have seen, one of the most devastating features of the present slump is the virtual disappearance of the will to invest capital in industrial development. Where the private investor refuses to invest Governments will have to step in. Nothing would be more likely to help, given the right international conditions, in promoting world revival than a large-scale and systematic policy of public development directly planned and financed by the Governments of the leading countries. With this would have to go a more liberal credit policy and, if possible, an international agreement under which each State would agree to liberate its currency system from the present shackles upon expansion, either on the basis of a reformed gold standard or through a system of related national currencies "managed" without any reference to a metallic standard.

State Provision of Work. In the years since the war a number of Governments have made half-hearted attempts to provide jobs for the unemployed through the development of the policy of public works. They have in the first place, when unemployment has first become severe, endeavoured to mitigate it by accelerating the execution of public works which they intended to carry out in any case in the near future. This was done in the anticipation of a short slump ; and any such policy can obviously be effective only if a slump is short. For the effect of accelerating public works is to diminish the amount of such works needing to be done in the ensuing years. The usual method adopted is to urge local authorities to put works of their own

promptly in hand, and to offer them special subsidies or opportunities for borrowing on easy terms with this end in view. Within a limited field this policy is effective for a time ; but, if the slump lasts long, the local authorities become more and more reluctant to charge the rates with expenditure on work which seems to them to be in the nature of a relief scheme for the unemployed, and therefore properly a charge on national rather than local taxation. The policy of accelerating public works, and even of stimulating additional works by subsidies to the local authorities, therefore very quickly exhausts its utility, as one Government after another which has attempted it has found.

Moreover when the present world slump set in it was accompanied by a financial crisis due largely to the burden of debts, which made Governments above all anxious to cut down their expenditures to the absolute minimum. But it always costs more in the sense of immediate out-of-pocket expenditure to employ a man than to keep him in idleness on some form of unemployment benefit ; for he is bound to be paid more for working than if he is left idle, and there are in addition the costs of materials used and of the organisation and supervision of public works to be taken into account. It therefore usually seems to Governments anxious to economise to be cheaper to leave men idle than to attempt to find them work. It can of course, be pointed out that to reckon the cost in these terms involves a complete ignoring both of the value of the product which the unemployed man could be used to create and of the deterioration in his future productive capacity likely to result from prolonged idleness. But Governments at their wits' end for money are concerned far more with the immediate contraction of expenditure than with sound economics ; and accordingly the onset of the world slump caused everywhere an abandonment or drastic cutting down of such public works as had been in existence at an earlier stage.

The Dangers of False Economy. But this policy of contraction is suicidal. Just at a time when private investment is most seriously damped down, Governments proceed to damp down public investment as well, thereby exaggerating depression and unemployment, and making the private investor more reluctant than ever to risk his money. What is needed from Governments in times of persistent trade depression is a courageous policy of public investment, designed both to replace the money which private investors refuse to bring forward and, by the indirect demand which it would create, to persuade these investors to re-enter the field. If, however, any such policy is to be successfully advocated, it must take a far more ambitious shape than a mere return to the policy which was already in operation on a small scale before the slump; for the great defect of this policy was that it confined government works almost exclusively to undertakings which could not be, and were not meant to be, financially reproductive in any direct sense. The State abstained carefully from competing with private enterprise, and in doing so precluded itself from undertaking just those types of work which would have been most influential in fostering industrial revival. A renewed policy of public provision of employment must not confine itself to road building and municipal public works. It must, in addition to a great development of housing, even beyond anything that has previously been done in this field, concentrate above all on efforts towards a real improvement in national productive capacity in forms likely to bring in a direct return—on the provision of money, on conditions, of course, for the reorganisation and re-equipment of the old basic industries, and for the development of new industries and services calculated to meet the changing demands of the consuming public. It can include within its scope such measures as the electrification of the main line railways; but it cannot be complete and effective unless it also takes in hand directly the rationalisation of existing industries and the development of new ones with the aid of national capital. The United States, with its relatively light taxation

and its enormous natural resources still awaiting development, is best situated for the adoption of a policy of this kind ; and the United States has the further advantage that it is in a position to increase its issues of currency and credit without any change in the basis of its monetary system. For, despite the large withdrawals of gold from the United States during the past year, America has still a vast amount of free gold at its disposal for the expansion of credit, as soon as it can find means of making this expansion effective.

It is indeed very doubtful whether the mere expansion of credit by the banks without parallel steps by the Government to create a demand for the additional credits by a policy of public development can achieve any substantial results. For will not the new money merely be returned to the banks as fast it is issued ? But, given a policy both of credit expansion and of national development under public control, the United States has it within her power to bring about industrial revival—provided only that at the same time the problem of international debts and the barriers in the way of international trade is being courageously tackled. No other country is in a position to do half so easily what the United States can do without risk ; for, even if she tried the policy of credit expansion and national development and failed, she could be at worst no worse off than she is now, whereas for other countries failure would involve far more serious perils. Germany, for example, cannot adopt a policy of national development or credit expansion while she is held to the gold standard by the Young Plan, or while she is still burdened by enormous claims for interest on reparations and other foreign debts ; and even Great Britain cannot proceed far without danger along these lines until she is sure that the United States is adopting the same course.

If the world is to emerge from its present troubles on the lines of a reconstructed Capitalism I can see no measure less than these which are likely to make emergence possible —and even so many of the forces which have brought about

the present slump are likely to remain in being so as to create future dislocations on a comparable scale. For the inherent tendency of Capitalism, to bring slump out of boom, owing to the maldistribution of current income between spending and investment, will be in no way affected by any of the measures which can be taken in order to set Capitalism again on its feet. Even if prosperity is restored, there will be a constant threat of further slumps ; and it would be utopian to suppose that the forces of economic nationalism could be so far killed once and for all that when the next slump comes there will be no political complications to increase its severity and prolong its duration. Moreover, the tendency towards maldistribution between spending and investment seems likely to be accentuated rather than lessened in future booms; for to the forces which have been in existence previously is now added the great force of rationalisation in bringing about a progressive displacement of labour, particularly at times of the most rapid technical advance. This displacement serves still further to prevent the expansion of consuming power, and of the will to consume in proportion to the rise in the productivity of the industrial system. This tendency was seen disastrously at work in the United States in the years immediately before 1929 ; and it is likely to pay a prominent part in future booms in other countries as well. For, as we have seen, modern technical progress is not content with the application of machinery so as to make labour more productive. It is tending also more and more to the direct supersession of human productive power by the machine. Nations could no doubt counteract the effects of this technical advance if they were prepared to pension off their entire working class as soon as it reached middle age ; but no one nation except the United States could do this unless others did it too. For it would inevitably add to the cost of production through higher taxation, and so hamper the exporting industries of any country which adopted the policy. Great Britain, the foremost country in the world in social legislation, has already found to her cost that the limits to advance

in this direction are set not by the volume by the national wealth but by the exigencies of international competition. It seems chimerical to suggest that the world should make an international agreement for the pensioning of its older workers as rationalisation advances. But how, without this, are the nations to prevent consuming power from being progressively lowered by the development of mechanisation? Even if world Capitalism at long last shows fresh power to face facts and to make co-operative efforts towards recovery on a scale sufficient to bring the present slump to an end—a very large assumption—that will not be the end of its troubles; for there are inherent flaws—contradictions as Karl Marx called them—in the world's present economic system, and these cannot be removed without profound changes in its underlying structure.

Chapter VIII: FOREIGN TRADE AND FISCAL POLICY

§1. A PRELIMINARY SURVEY

All developed countries live to some extent by foreign trade. They need to import certain commodities in which they are short of natural resources or of the ability to manufacture, and they have to export goods in order to pay for their imports. In the case of the countries which are at the earlier stages of economic progress payment has usually to be made as well for imports of capital—that is, chiefly capital goods such as railway material and machinery required for the development of the country. Foreign trade is primarily an exchange of goods for goods; but this apparently simple relation between countries is complicated both by capital movements through which one country incurs a charge for interest and repayment of the principal of loans from another, and also by the purchase of services, as for example when the imports and exports of one country are carried largely in the ships or over the railways of another, or when the citizens of one country spend money in another by way of holidays or immigrant remittances to relatives at home.

In the case of the larger and more developed countries

especially the position is further complicated by the fact that the lesser countries rely to a considerable extent on getting their foreign trade financed through the great monetary centres, especially London. A large part of the world's foreign trade is financed by means of bills drawn on London ; and a great deal of insurance both of ships and of goods is also placed on the London market.

Any account of the trading relations of the various countries of the world has therefore to include not only the movement of goods from one country to another but also the payments due apart from the current movement of goods. The balance of trade between countries is usually measured by comparing the amounts of goods currently imported and exported between them ; but the balance of payments, which is for many purposes the more important consideration, includes the " invisible " as well as the " visible " items, and has to bring into the reckoning not only current payments in respect of services as well as goods but also sums due on account of past capital investments and current capital movements of fresh investments or short-term lending.

Although all developed countries depend in some degree upon foreign trade, there are very great differences in the degree of dependence between country and country. Some countries consume at home most of what they produce, and are little dependent on either imports or exports for their means of living ; while others produce largely for the foreign market and rely on obtaining in exchange for their exports a wide variety of goods which they do not produce at home. Those countries which depend greatly on foreign trade fall into two groups. The first group includes the advanced manufacturing nations of Europe, such as the United Kingdom, Belgium, Germany and to a less extent France ; while the second group includes countries which are primarily exporters of foodstuffs and raw materials, and import in exchange for these primary commodities a large quantity of manufactured goods.

The position as between country and country can best be

PERCENTAGE SHARE OF LEADING COUNTRIES IN WORLD TRADE, 1929

	Imports	Exports	Total	Exports as per cent of Imports
United Kingdom	15.3	10.8	13.2	69
U.S.A.	12.2	15.8	13.9	114
Germany	9.1	9.2	9.1	97
France	6.5	6.0	6.2	75
Canada	3.5	3.4	3.5	92
India	2.6	3.6	3.1	117
Japan	2.8	3.0	2.9	97
Holland	3.1	2.4	2.8	74
Italy	3.2	2.4	2.8	69
Belgium	2.8	2.7	2.8	91
Argentine	2.4	2.8	2.6	127
China	2.3	1.9	2.1	76
Australia	1.9	2.1	2.0	101
Czechoslovakia	1.7	1.9	1.8	103
Dutch East Indies	1.3	1.8	1.5	127
British Malaya	1.4	1.6	1.5	103
Sweden	1.3	1.5	1.4	102
Spain	1.5	1.2	1.4	77
Switzerland	1.5	1.2	1.4	77
U.S.S.R.	1.2	1.4	1.3	106
Denmark	1.3	1.3	1.3	95
Brazil	1.2	1.4	1.3	109
Union of South Africa	1.1	1.4	1.2	109
Austria	1.3	0.9	1.1	67
Poland	1.0	1.0	1.0	90
Irish Free State	0.8	0.7	0.8	78
Egypt	0.8	0.8	0.8	95
New Zealand	0.7	0.8	0.7	114

seen by means of the following table, which shows the value in gold dollars of the foreign trade of certain of the leading countries per head of the population. The year 1929 has been selected for use in this table because it represents conditions before values of imports and exports were profoundly upset by the great change in relative prices which followed upon the world slump.

New Zealand and Denmark. It will be seen from these figures that the country which has by far the largest value both of imports and of exports per head of population is not, as might have been expected, one of the great manufacturing countries of Europe but New Zealand, which produces chiefly foodstuffs for the world market and above all for the market of the United Kingdom. New Zealand exports meat, butter, eggs, and a wide range of the more expensive foodstuffs, and receives in exchange, largely from the United Kingdom, the manufactured goods which, owing to her small area and population, she is ill equipped to produce for herself. The second country on the list—Denmark—is in a very similar position. She too is a small country, poorly equipped for undertaking a wide range of manufacturing production and therefore preferring to concentrate on intensive agriculture for the supply of other countries with the more expensive types of foodstuffs. Denmark, like New Zealand, depends very largely on the British market ; for great Britain is, of all the countries of the world, the largest importer of foodstuffs of these kinds. Holland, which stands third on the list, also exports large quantities of meat, dairy produce and other foodstuffs whose value is considerable in relation to their bulk ; but Holland is to a greater extent than either Denmark or New Zealand a manufacturing country as well.

Canada. Fourth on the list is Canada—now the world's leading granary—with the largest exportable surplus of wheat for the world market. Canada has since 1914 enormously increased her area under wheat and thereby made

IMPORTS AND EXPORTS PER HEAD OF POPULATION, 1929, FOR SELECTED COUNTRIES

(In Dollars)

	Imports	Exports	Total
New Zealand	158	176	334
Denmark	129	123	252
Holland	141	102	243
Canada	127	114	242
Belgium	119	108	227
Switzerland	127	99	226
Australia	106	107	213
United Kingdom	118	78	196
Sweden	78	80	157
Argentine	75	81	156
France	55	47	101
Germany	50	47	97
Union of South Africa	44	52	96
U.S.A.	35	42	77
Italy	27	19	46
Japan	16	15	31
Poland	11	10	21
India	3	4	6
U.S.S.R.	3	3	6
China	2	1	3

herself very dependent on the vagaries of the world wheat market. She has, however, at the same time, greatly increased her industrial production, chiefly for her growing home market. Canada is in fact now passing through a stage through which the United States passed more than half a century ago ; and with her extensive area and her abundant natural resources she has obviously a great capacity for absorbing additional population. As her population becomes denser she will tend to consume more of her own raw produce, and to depend less on the world market for primary goods. But she is at present passing through a somewhat difficult phase, in that her population is not yet large enough to promote an all-round development of manufacturing production for the home market, while the difficulties of the agricultural situation make it uneconomic for her to continue to increase the acreage devoted to the production of wheat for export. There is already some tendency in Canada to shift over from the mass production of wheat under prairie conditions to more mixed types of farming less dependent on the world price of a particular commodity. There is also a tendency of late years to raise tariffs on imported manufactures higher and higher in order to stimulate the development of manufacturing industry at home. Canada is the outstanding example of a country whose prosperity depends greatly on the world market for a single export—wheat—but which at the same time is rapidly developing towards a more balanced relation between industry and agriculture through the expansion of her manufacturing output.

Belgium and Switzerland. The next country on the list is Belgium—the most densely populated industrial area in Europe. Belgium has for more than a century specialised in the production of cheap industrial goods for the world market. Wages and cost of living have alike been low ; and this has given the Belgian manufacturer an advantage in competing with the larger industrial countries. Since the war the Belgian customs area has been expanded by the

inclusion of Luxemburg ; and this has given her an important position amongst steel producing countries. Dependent chiefly on imports of foodstuffs and raw materials and on the export of manufactured goods for her means of life, Belgium has been throughout a low tariff country ; for her interest is obviously far more in expanding her share of world trade than in endeavouring to make herself more self-sufficient within her restricted area. She is like Denmark in her extreme dependence on the consuming power of the world market ; but, whereas Denmark is primarily an importer of manufactures and an exporter of foodstuffs, in the case of Belgium the position is reversed.

Switzerland, the next country on the list, is also chiefly an exporter of manufactured goods such as clocks and watches, manufactured silk and artificial silk, certain types of machinery, condensed milk and chocolate ; while she imports chiefly foodstuffs and a large part of the raw materials used in her manufactures. But in the case of Switzerland the nature of her foreign trade gives a particularly inadequate idea of her international position ; for she is above all a country which lives largely by tourist traffic, and obtains the means of buying goods from abroad largely through the tourist expenditure of foreigners from all parts of the world. The invisible items bulk very large in Switzerland's balance of payments ; and if these were included she would stand even higher in the list than she actually does.

Australia. After Switzerland comes Australia, again a country exporting foodstuffs and raw materials and importing chiefly manufactured goods, but even more than Canada a country which has endeavoured behind a high tariff wall to foster home manufactures and to maintain a high standard of life for her population. Australia is not so dependent as Canada on the export of a single commodity. Wool, in the raw state, is by far her most important export, followed at a considerable distance by wheat, of which the quantity exported varies greatly from year to year according to fluctuations in the harvest. Australia imports a very wide

range of manufactured goods, among which machinery and other goods made of metal and textile manufactures are the most important. Her internal costs of industrial production are high, and her domestic market owing to the size of her population relatively small ; and for these reasons she has only been able to develop a diversified range of manufactures by means of a very high tariff, for which the Australian consumer has had to pay. Her minimum wage laws have been a contributory cause in keeping her costs high ; and, on a short view, it seems as if it would have paid her better to concentrate more largely on agricultural production than she has actually done. The correctness of this view depends largely, however, on her future capacity to absorb population ; and this is a very doubtful matter. The interior of the country is largely dry, and can only be made suitable for intensive development if means can be found for its effective irrigation. The present population is confined largely to the coastal areas, and within these regions the possibility hardly exists of developing a sufficiently extensive home market for cheap mass production of a wide range of manufactures. Some people hold that in the future the problem of opening up the interior for effective economic development will be successfully solved, so as to make possible an economic development of Australia comparable with that of the United States in the nineteenth century and with that of Canada to-day. But this seems doubtful, and, unless it can be done, Australia is bound to remain a country largely dependent on world trade—an exporter of foodstuffs and agricultural materials and an importer of manufactures, however high her tariff walls may be.

Great Britain. At length, eight on the list, we come to the United Kingdom. We are so apt to think of Great Britain as the country which above all others depends for her prosperity on world trade that it is at first sight surprising to find that the value of her foreign trade per head of population is only two-thirds of that of New Zealand,

and of her exports less than half. It will also be noticed that, in the case of the United Kingdom as in those of Holland and Switzerland, imports per head are far larger than exports. This situation is possible in the case of Switzerland on account of the large " invisible export " of tourist expenditure. In the case of Great Britain and Holland it arises mainly because both these countries are great creditor nations and also undertake on a considerable scale financial operations in respect of international trade other than their own. In Great Britain's case a substantial part of the balance of imports has also to be set against the earnings of her shipping.

Even in respect of imports, however, Great Britain only stands seventh among the countries included in the list. She is neither so highly specialised as Belgium or Switzerland as an exporter of manufactures, nor so dependent on imports as the countries which specialise most intensively on the production of primary foodstuffs and materials for the world market. Her imports consist, of course, mainly of foodstuffs and raw materials ; and of foodstuffs she is by far the largest importer in the world—buying from abroad more than the United States and Germany, the two next largest importers, put together. In 1928 the United Kingdom imported £469,000,000 worth of foodstuffs as against Germany's £205,000,000, the £202,000,000 of the United States and the £101,000,000 of France. In the import of raw materials she has not quite the same importance—the value of her imports being substantially less than that of the United States and about the same as Germany's. But even for raw materials, despite the decline in her demand owing to her decreased export trade, she is normally the second largest market in the world. In 1928 the United Kingdom imported £363,000,000 worth of raw materials as against the £418,000,000 of the United States and the £354,000,000 of Germany.

Great Britain is also a large importer of manufactured goods—larger than any other country in the world except the United States, with which she stands about on a level. But

her imports of manufactures are considerably less than of either foodstuffs or raw materials. In 1928 she imported £225,000,000 worth of manufactures (including semi-manufactures), whereas the United States imported £216,000,000 worth and Germany £120,000,000.

When we turn to the other side of the account we find that Great Britain is quite unimportant as an exporter of foodstuffs, and in respect of raw materials important only as an exporter of coal. Her exports consist chiefly of a wide range of manufactured goods, among which textiles still occupy the position of pre-eminence, followed by iron and steel and engineering products. Apart from her very great dependence on the export of cotton goods, largely for the Far Eastern market, and upon her trade in coal, Great Britain is in the main an exporter of highly finished and relatively expensive manufactured commodities, including a great many capital goods such as ships, railway material and machinery. She therefore depends for her prosperity very largely on the prosperity of the rest of the world ; for her ability to sell capital goods abroad varies with the pace of economic development in the world as a whole and above all in the British Empire, and the demand for her highly finished consumers' goods depends on the maintenance and improvement of the standard of life in the world as a whole. It is in this sense, and not in having a larger volume of imports and exports per head of population than the countries described above, that Great Britain is the country most dependent on foreign trade and the absorptive capacity of the world market.

Argentina. Beyond this point it is no longer necessary to go down the list in detail country by country ; and we may reasonably content ourselves with the selection of a small number of further examples. The Argentine, which comes tenth, depends chiefly on the export of foodstuffs, among which meat, wheat and maize are by far the most important. She is also a large exporter of linseed, hides and raw wool, while her imports are chiefly manufactured goods

and petroleum, and include a large quantity of capital goods, such as railway material, designed to foster the economic development of the country. Great Britain has long been the chief supplier of the Argentine with capital for the improvement of her public utility services ; and the Argentine depends greatly on Great Britain as a market. Indeed the economic relations between the two countries are so close that the Argentine has often been described as lying economically though not politically within the British Empire. This, as we shall see, raises important problems in British fiscal policy, especially in connection with any attempt to foster inter-imperial trade or to make the British Empire more a closed system on a basis of tariff preferences or " Empire Free Trade."

France and Germany. France and Germany occupy respectively the eleventh and twelfth places in trade per head of population ; but of course since Germany is considerably the more populous country she has by far the larger aggregate foreign trade. French overseas trade was greatly increased in importance by her territorial acquisitions at the end of the war, as these transferred to her an important part of the industrial area of pre-war Germany, including especially the steel-producing area of Lorraine. In comparison with the nations ahead of her on the list she is a self-contained country, far less dependent than either Great Britain or Germany on the import of foodstuffs ; but she needs to import very large quantities of the raw materials in which her territories are deficient. In 1928 France spent three times as much on imported materials as on imported manufactures, and nearly two and a half times as much as on imported foodstuffs. Her exports, on the other hand, consist mainly of manufactured goods, and especially of luxury products such as silks and fine quality goods of cotton and wool. But she is now also an important exporter of iron and steel, drugs and chemicals and of certain types of tools and machinery. France is a good deal less able than before the war to do without the foreign market owing to the industrial

structure of the new territories which she has acquired ; but she has in the long run a greater capacity within her new borders to make herself self-sufficient than either Great Britain or Germany.

The German economic system was fundamentally upset by dislocation caused during the war and by her loss of territory at its close. The new frontiers were drawn clean through the middle of her most important industrial districts. The Lorraine iron was cut off from the Ruhr coal, and the new Polish-German frontier marched through the centre of her next most important industrial area. These losses compelled her to undertake a thoroughgoing reconstruction of her entire economic system ; and she has never been able to regain her pre-war position as an exporter to the markets of the world. She has, however, largely by means of rationalisation carried through with the aid of American capital, made a heroic attempt to re-establish her position ; and especially during the past few years she has strained every nerve to expand her exports and at the same time to reduce her dependence on imports in order to meet both the heavy burden of reparations laid upon her by the Peace Treaty and the interest on the large masses of capital which she has been compelled to borrow since the war. Germany, like Great Britain, is unimportant as an exporter of foodstuffs, of which before the recent slump she imported more than six times as great a value as she sent abroad. Her exports consist chiefly of manufactures ; and in these, before the slump, she stood about level with the United States, but still substantially behind Great Britain. But it is only possible for her to export on this scale if she imports a considerable quantity of raw materials, such as iron and other ores, copper, raw wool and cotton, timber and tropical products. She has also to import foodstuffs, including wheat, barley and maize, fruit and coffee, on a large scale ; and her efforts during the past few years to build up an export surplus for payment of reparations and interest on her foreign debt have involved a contraction of imports which could be made only at a heavy expense to

the standard of life of her people. Germany could even for a brief period under present conditions only make her international payments, including interest and reparations, balance by the most extreme measures of restricting imports and by a highly artificial stimulus to the export trades through selling her manufactures cheap to the foreigners at the cost of raising their prices at home. The maintenance of such sustained efforts over any considerable period of time could from the first have been seen to be impossible ; and it is not surprising that the effort to carry it on has involved both default and a mood of acute unrest or sheer despair among the German public.

The United States. Still lower down by this reckoning of imports and exports per head of population comes the United States, occupying the fourteenth place. For, despite the fact that the United States has, or had before the world slump, the highest standard of living in the world for nearly all classes of the population, except the negroes and the poor whites in the South, the value of her imports and exports is small in relation to that of her internal production. The United States is in a position, with her huge area and population, to be largely self-contained ; for she has the power to produce from her own resources most of the foodstuffs and raw materials which she requires, while the size of the internal market enables mass production for home use to be effectively applied over almost the whole range of manufactured goods. The United States is, of course, absolutely of very great importance in world trade. Of raw materials she is by far the largest exporter in the world ; and her exports of foodstuffs are still considerable despite the rapid growth in the consuming power of her own people. She is, moreover, despite the abundance of her native resources, the world's largest importer of raw materials. She absorbs huge quantities of raw silk, crude rubber, wood pulp for paper, jute, copper and tin, hides and skins as well as coffee, raw sugar and other specialised foodstuffs. Her imports of raw materials are as large as her imports of foodstuffs and

manufactures put together, and she is accordingly an exceedingly important market for those countries which specialise in the production of those types of materials in which she is herself deficient. Japan's silk and the rubber of Malaya and the Dutch East Indies find their principal market in the United States. As an exporter of foodstuffs the United States of America is, as we have seen, of decreasing importance ; but she remains enormously important as an exporter as well as an importer of raw materials. Raw cotton is by far the most important of all her exports—accounting in 1928 for nearly one-fifth of the total value. For the rest her exports are widely diversified—automobiles and refined petroleum standing out as the most important after cotton. In 1928 raw materials accounted for $38\frac{1}{2}\%$ and manufactured articles for $37\frac{1}{2}\%$ of her total exports—both being valued at over two thousand million dollars in that year. The United States, although her foreign trade is relatively small if it is measured per head of population, is thus by no means in a position to dispense with the world market, or insensible to the shocks administered by world depression to her internal economic system. She is less dependent on foreign trade than the leading nations of Europe ; but she is quite dependent enough for talk about economic isolation or the desirability of rebuilding her internal prosperity without regard to conditions in the rest of the world to be no better than dangerous nonsense.

The United States is followed in the table successively by Italy, Japan and Poland. Thereafter comes a gap ; for I have not given a table including all countries but only those whose position appeared to possess some special significance worthy of comment. The last three countries, India, Soviet Russia and China, are included by way of contrast to the others, and not because they come next in serial order.

The Far East. The foreign trade of India and China, it will be observed, is insignificant in relation to the vast populations of these countries. China's total trade per head of population is less than one-hundredth of that of New

Zealand, and India's less than one-fiftieth. This is of course accounted for partly by these countries being still for the most part undeveloped peasant communities living at a very low standard on a basis of subsistence agriculture. They are densely populated, and their land is divided up into tiny holdings from which the majority of their populations can barely scratch their subsistence. We hear a great deal of the recent development of the factory system in the mills of Shanghai and Bombay, and of the growth of Western methods of trade and Western facilities for communication in the Far East ; but these things have barely touched the fringe of the Indian and Chinese economic systems. Of the countries of the Far East only four have attained to any substantial development of production for the world market in relation to the size of their populations. These are Malaya and the Dutch East Indies, with their specialised production of rubber, Ceylon with her great tea plantations, and above all Japan. But even Japan, despite her intensive effort to adopt Western technique and to naturalise machine production within her borders, still depends primarily on the export of raw silk, and is still to a great extent, like China and India, a peasant country with very small agricultural holdings, on the produce of which the mass of her people live at a very low standard eked out by the cultivation of the silk-worm as a subsidiary occupation.

Poland and Central Europe. Poland owes her importance and her inclusion in the table mainly to the already developed industrial area which she inherited from Germany at the conclusion of the war. She is important above all as an exporter of agricultural produce and of coal from the Silesian coal-field ; and her remaining industries are still of relatively little importance in the world market.

Apart from coal and zinc her most important exports are timber, pigs, eggs, sugar and certain other foodstuffs and semi-manufactures. She is an importer chiefly of raw materials such as cotton, and of manufactured goods, especially machinery ; and she is of great importance as a market

for the industries of Germany, Czechoslovakia and Austria as well as of Great Britain. She is obviously a country capable of great development in the future, especially if the conditions of trade in Eastern and Southern Europe become free enough to enable Poland and her neighbours to specialise in the production for exchange of the goods for which each is best fitted, instead of maintaining high tariff walls one against another, and thus raising costs of production everywhere to an unnecessary height. Poland has been hard hit during the slump as an agricultural exporter ; and she is very short of capital for the development of her industries. Her position, moreover, is politically precarious, and must remain so as long as she continues to be on bad terms with Soviet Russia as well as with her smaller neighbours.

Soviet Russia. We come finally to the Soviet Union, with a foreign trade no higher in 1928 per head of population than that of India. There has indeed since this date been a remarkable increase both in the internal production and in the exports of the U.S.S.R. which is beginning to reassert her old claim to serve as the granary of Europe. Russia to-day, as before the war, is an exporter of foodstuffs and raw materials, especially wheat, timber, petroleum and jute. Her intensive effort under the Five Years' Plan to develop her manufacturing production has necessarily involved the purchase of considerable quantities of agricultural and industrial machinery and of transport material from abroad ; but Russia is making at present a tremendous attempt to render herself as far as possible self-sufficient even in those industries which require the most developed productive technique. Her vast population, which is rapidly increasing, and the abundant natural resources which exist within her borders, obviously make her capable, if she can find among her people the necessary qualities of managerial efficiency and factory discipline, of becoming even more self-contained than the United States, because of the greater diversity of her climate and her capacity for raw material production. Her market is amply large enough, if it can

be developed, to provide for the fullest specialisation in almost every branch of manufacture ; and it can be taken as certain that, while for the moment she may be endeavouring to expand her exportable surplus of wheat, timber and oil in order to pay for necessary imports, she will at a later stage tend to produce at any rate wheat and oil more largely for home consumption, and may even become before long more important as an exporter of manufactured goods than of raw produce. But this depends largely on the attitude which the rest of the world takes up towards Russia. Any kind of boycott now or a refusal of adequate credit facilities would intensify her tendency to make herself as self-sufficient as possible within her own area and, by reducing her long-run dependence on imported manufactures, reduce also her necessity to export goods in payment for imports. We shall have to consider the whole outlook for the U.S.S.R. in relation to the rest of the world more fully at a later stage ; here we need only observe that Russia's present position in world trade is obviously out of all proportion to her resources and her productive capacity. It is a legacy of the isolation thrust upon her by war and revolution ; and it is for other countries as well as for herself to determine whether this isolation shall continue, or a large-scale exchange of commodities between Russia and the rest of the world be developed for the benefit of both. It is safe to say that the rest of the world needs the Russian market far more than Russia does—or will in the near future if her isolation is allowed to continue—need the rest of the world ; and those who are still endeavouring to organise a boycott of Russian trade would do well to mark, learn and inwardly digest this significant fact.

§2. THE WORLD TRADE OUTLOOK

THIS GENERAL survey of the position of the leading countries engaged in foreign trade brings out certain striking contrasts. There are not only great differences in the degree

PERCENTAGE DECLINE IN THE VALUE OF IMPORTS AND EXPORTS OF CERTAIN COUNTRIES DURING THE WORLD SLUMP

Imports—Percentage Fall in Value, 1929 *to* 1931

Over 70 per cent.	Australia.
Over 50 per cent.	U.S.A., Canada, Germany, Spain (gold values), Finland, Latvia, Esthonia, Poland, Turkey, Chile.
Over 40 per cent.	Italy, Hungary, Austria, Roumania, Bulgaria, Czechoslovakia, Greece, Argentine, Brazil, Egypt, India, Ceylon, Japan, Malaya, New Zealand.
Over 30 per cent.	Holland, Belgium, Portugal, Yugoslavia, South Africa.
Over 25 per cent.	Great Britain, France.
Over 20 per cent.	Norway.
Over 15 per cent.	Sweden, Denmark, Switzerland, Ireland,
Under 15 per cent.	Lithuania.

NOTE.—In the case of the U.S.S.R. there has been an *increase* of 27 per cent. (gold roubles).

Exports—Percentage Fall in Value, 1929 *to* 1931.

Over 60 per cent.	Chile.
Over 50 per cent.	U.S.A., Spain (gold values), Malaya, South Africa.
Over 40 per cent.	Great Britain, Canada, Australia, India, Ceylon, Japan, Hungary, Austria, Greece, Esthonia, Latvia, Egypt.
Over 30 per cent.	France, Italy, Sweden, Norway, Finland, Holland, Poland, Yugoslavia, Switzerland, Czechoslovakia, Argentine, New Zealand.
Over 25 per cent.	Germany, Belgium, Portugal.
Over 20 per cent.	Denmark, Roumania, Ireland.
Over 15 per cent.	Lithuania, Turkey.
Under 15 per cent.	Russia, Belgium, Brazil.

PERCENTAGE DECLINE IN TONNAGE OF IMPORTS AND EXPORTS OF CERTAIN LEADING COUNTRIES DURING THE WORLD SLUMP

Country	Percentage Decline 1929 to 1931 Imports	Exports
Germany	39	5
France	2	24
Belgium	14	5
Holland	3	+3
Italy	23	12
Switzerland	+4	33
Czechoslovakia	17	44
Austria	22	38
Hungary	50	32
Yugoslavia	32	38
Roumania	48	+42
Turkey	51	+32
Greece	8	21
Poland	42	11
Finland	22	26
Esthonia	26	8
Latvia	33	42
Lithuania	5	35
Argentine	32	+11
Brazil	42	+2
Japan	14	15
New Zealand	33	20

of dependence of the various countries on imports and exports for their means of life, but also marked divergences in the character of this dependence where it exists. Thus some countries specialise in the production of manufactured goods for export, and others in foodstuffs and raw materials ; while yet others are important as exporters both of primary products and of manufactured articles. Some of the countries engaged in manufacture have within their own borders abundant supplies of most of the materials which they need, while others have to import a considerable quantity of the raw materials which they use up in the production of finished goods for export. Some countries approach what is known as a " balanced " economy—that is to say, their populations are divided between industrial and agricultural pursuits in such a way as to lead to a high degree of self-sufficiency—while others need to import foodstuffs on a very large scale, or are almost entirely dependent on overseas production for their supply of manufactures. Generally speaking, countries which specialise in producing manufactured goods for export make a fairly wide range of commodities and are not dependent mainly or exclusively upon the market for a single group of products. On the other hand, some of the countries which are mainly producers of foodstuffs and raw materials depend in a very high degree on a single commodity, such as wheat or rubber or tea, and are therefore peculiarly liable to have their economic systems seriously upset by any disturbance in the relative price levels of the commodity which they export and the wide range of goods which they need to buy. Other countries, however, although they are specialised as producers of primary goods, do not depend to anything like the same extent on the market for a single commodity ; and these countries are in a better position for standing up against shocks arising in the particular markets in which they are interested, though they are of course liable, with all other countries, to the effects of any general depression in trade.

Our survey has shown us a world very highly organised for the mutual exchange of goods among countries between

which the division of labour has been pushed in some cases to very great lengths ; but if we compare pre-war and post-war foreign trade we shall at once be struck by certain changes which have come over international economic relationships since 1914. Since then the total volume of goods passing in overseas trade, as well as their total value has certainly increased—or had increased up to the coming of the world slump. But it is more than doubtful whether this increase had kept pace with the advance in world economic productivity. It is safe to say that there was at least some tendency for countries to become more self-sufficient and to depend less on the import of commodities from abroad, and therefore on the export of commodities to pay for imports.

The Tendency to National Self-Sufficiency. How does this tendency arise ? In part it can reasonably be regarded as natural, whereas in other aspects it is definitely artificial and from the standpoint of world productivity wasteful and uneconomic. It is natural where it is the result of the development of the economic resources of a country previously unexploited, or exploited to an inadequate extent. Thus it is perfectly natural that countries such as India and China should in the course of time give up depending on the countries of the West for as large a part of their manufactures as they have imported hitherto, and should endeavour to naturalise Western methods of production within their own borders. Calcutta, Bombay and Shanghai, as well as the industrial centres of Japan, were bound to develop at some stage spinning mills and weaving sheds for the supply of the vast internal markets of the Far Eastern countries. The interruption of supply from Europe on account of the war undoubtedly speeded up the industrialisation of the Far East ; but this was proceeding before the war, and would have gone on in any case, probably at a rapidly increasing rate. Modern power-driven machinery of the more automatic types is very well adapted to be worked by labour much less equipped with technical skill

than the labour of Western Europe and the United States—long accustomed to industrial methods of production. It was always certain that at some time the Lancashire cotton industry would lose its virtual monopoly of the Far Eastern markets, and that competition would begin with the spinning of yarn and the cheaper and more easily manufactured types of cloth, just as it had begun at an earlier stage in the jute mills of Calcutta. It was also inevitable that the resources of coal and iron long unused in Asia would begin to be exploited and metal industries to arise in the Far East to rival the old-established industries of the West. It is true that in the metal trades Far Eastern competition was likely to encounter greater difficulties than in spinning yarn and the manufacture of cloth, because the making of metal goods involves for the most part a technique which cannot be so completely transferred to the machine. But in railway material and in the heavy iron and steel trades there were obviously opportunities for the development of local industries for the supply of an extending local market.

This, of course, need not have meant any positive contraction in the demand for imports ; for it was reasonable to suppose that, as industrialisation proceeded in the Far East, it would bring with it a rise in the standard of life and an expansion in the total consuming capacity of the Far Eastern markets. Even if the Far Eastern countries produced more for themselves, and adopted to an increasing extent modern methods of power-production, the total increase in their consuming power might still remain adequate to allow their demand for imports to be maintained or even considerably increased. But there was bound in this event to be a change in the character of their demand for Western products. They would tend to buy less of the cheaper kinds of consumers' goods and of the more easily manufactured capital goods ; but on the other hand their demand for the more complicated types of machinery and industrial equipment would increase, and as the standard of life rose there would be a larger demand for products of

higher quality, in which the Western world would be likely for some time to maintain its superiority as a producer. If the total wealth of the Far East had increased at a satisfactory rate, Western countries would have needed to adapt the organisation of their export trades to the supply of new kinds of products ; but they would not have needed to fear any contraction in the total Far Eastern demand for Western goods.

The Far Eastern Market. Some increase in the consuming power of the Far East there has undoubtedly been; but industrialisation has not gone nearly far enough to have any effect on the economic position of the great mass of the population of Far Eastern countries, except in Japan, where the standard of living undoubtedly went up to a substantial extent during the years immediately after the war. Moreover, as the Far Eastern countries still depend for their ability to buy Western goods mainly on their exports of primary products, they have been exceptionally hard hit by the world slump, which has reacted with exceptional severity on the prices of these classes of goods. In the case of China purchasing power has been further depreciated by the heavy fall in the value of silver ; and accordingly the legitimate expectations of a steady expansion of purchasing power in the Far East have not been realised, and the falling off in the demand for the cheaper and simpler products has not been compensated by a rise in the demand for the more highly finished manufactures and instruments of production. There is nothing more important for the Western world than that the standard of living in Asia should rise. So far from having an interest in keeping Eastern standards low in order to hold the existing markets, Europe and the United States have alike a strong interest in fostering the economic development of the Far East in order to expand the demand for high quality products. The Far Eastern countries will thus become less dependent on imports than they are at present for their supply of manufactured goods ; but their total demand will be so increased

that the more advanced industrial countries will stand to gain by the change.

Of course a further factor in depressing the demand of the Far Eastern countries has been the uncertainty in recent years of the political situation. China has been ravaged continuously by civil war ; and in India the rise of the Nationalist movement has done something to slow down the pace of industrial development through the uncertainty which it has caused in the minds of Western capitalists concerned with the safety of Asiatic investments. But in the case of India at least the political factors have been definitely less important than the economic.

The Limits of Economic Nationalism. The development of manufactures in the Far Eastern countries is thus a perfectly natural and logical thing—as natural and logical as the rapid industrialisation which is now proceeding in Soviet Russia. Nor is it unnatural that certain of the new countries created by the Peace Treaty, such as Poland, should seek to develop their economic resources by the creation of new industries within their borders. Some degree of economic nationalism of this kind is to be expected and not to be regretted ; for the redrawing of political frontiers under the Peace Treaty was bound to cause some reshaping of economic areas in accordance with the new political boundaries. This is natural and inevitable whereever the new industries which it is endeavoured to localise or develop have a reasonable prospect of being carried on economically. But this qualification is of very great importance ; for different regions of the world have obviously very different degrees of suitability for different types of manufacture, and in many industries of to-day production can only be economic if it is carried on upon a very large scale. It is definitely uneconomic for a small country to endeavour to develop a wide range of manufacturing production for a small home market ; and in small countries it can only pay to localise industries which can either be run efficiently on a small scale or can be run so efficiently as to stand a chance

of competing effectively for a share in the export market. There is a strong prima facie case against attempting to establish any industry which, in order to retain even the home market, seems likely to need the permanent protection of a tariff or some other form of restriction on the supply of foreign goods. The smaller a country is the less diversified is the range of industries which it can afford, other things being equal, to develop ; and there can be no doubt that in many of the smaller States of Europe especially the attempt has been made to localise far more industries than these countries can effectively support. The result is seen in very high tariffs and in all manner of restrictions on imports, which severely limit trade between neighbouring countries and result in altogether unnecessarily high productive costs.

This situation applies not only to the new States created by the Treaties of Peace, but to other small countries as well. For during the war most countries found their normal supplies of manufactured imports seriously interrupted by the pre-occupation of the great manufacturing nations with the production of munitions and with the actual conduct of the war. They were therefore impelled to start industries of their own which would not have stood a chance of establishing themselves in normal times. But as soon as an industry has been established in any country it becomes a vested interest ; for the livelihood of a large number of workers, as well as the capital of a number of investors, has come to depend upon it. If, therefore, it is suggested that the industry is uneconomic and should be allowed to die as soon as the normal supplies from abroad once more become available, there is certain to be an outcry from those engaged in the industry and a strong demand for protection. The vested interests concerned in a whole group of industries which find themselves in this position join forces, and on their united demand new forms of protection are granted or the existing protection increased. This results in the inhabitants of these countries paying more than they need for the products of industries which are enabled to live only

under these conditions. It may be held that this is not too great a price for escaping the economic disturbance which would result from allowing the industries to die ; but tariffs originally granted for the purpose of preserving uneconomic industries are dangerous instruments, especially in times when world trade is depressed. For as depression increases the larger countries which used to supply the markets of the smaller find an increasing difficulty in disposing of their products. They are therefore tempted to cut their prices in order to secure the re-entry of their goods into the protected markets even over the high tariffs which have been imposed in order to keep them out. The smaller countries then retaliate by raising their tariffs still higher, and the larger countries in turn have further resort to "export dumping." Thus a degree of protection which may have seemed moderate in the first instance soon becomes immoderate when it is used as an instrument for countering the consequences of a world depression of trade. This is one of the main reasons for the sharp rise of European tariff levels, and for the introduction of all manner of new restrictions on imports where tariffs have shown themselves inadequate in recent years. The result is that all over Europe millions of consumers are being called upon to pay for certain classes of manufactured goods prices that are out of all relation to the cost at which these goods could be produced if all Europe formed a single economic unit.

The Growth of International Competition. The industrialisation of the Far East thus stands at one extreme and the attempts of small European States to naturalise too wide a range of manufactures at the other. But between these two extremes a number of more controversial changes have come about in the world's international economic structure. Great Britain, as we have seen, had through the greater part of the nineteenth century almost a monopoly in the world's market for any class of high grade manufacturing production on which she chose to specialise. Nineteenth century economists interpreted this situation as showing

that Great Britain enjoyed a special advantage for the production of textile goods, iron and steel, machinery, ships and other goods which made up her staple exports. They did not realise to what an extent this advantage arose simply from her being first in the field, possessing for a time a higher degree of technical and manufacturing skill, and enjoying as a result the advantage of high profits which gave her an abundant supply of new capital for industrial development. As new countries—partly out of their own resources, and partly with capital borrowed from abroad—imitated the productive technique of Great Britain these advantages tended gradually to disappear, and it became manifest that to a great extent they were based not on any natural superiority of the British conditions, but simply on the priority in time of the Industrial Revolution in Great Britain. Moreover, as machine technique improved, more and more skill, as we have seen, was transferred from the individual operative to the machine : so that the most modern productive methods became easier to learn and easier to adapt to the circumstances of any given country. It gradually became clear that modern machine technique was likely to result, not, as the economists of the nineteenth century had believed, in each country developing its efficiency in a different range of industries, but rather in all countries, as their economic resources increased, tending to develop to a considerable extent the same types of production. Each new country as it advanced in industrialisation took up not only the production of textile goods—especially woollens—under the factory system, but also the manufacture of iron and steel and of the engineering and shipbuilding, electrical and other products dependent on the advance of iron and steel production.

These developments were bound sooner or later to be fatal to the British monopoly. Nay more, they were bound to give those countries which had larger home markets than Great Britain herself some positive advantage. This was seen most clearly in the case of the United States with her tremendous development of the heavy industries in the

latter part of the nineteenth and the first decade of the twentieth centuries. It was seen also to some extent in Germany ; and it is likely to be seen even more clearly in the course of the industrialisation which is now proceeding in Russia.

Inevitably this means, among the large manufacturing nations of the world, a greater degree of self-sufficiency in the production of manufactured goods, including producers' and consumers' goods alike. But, as we have seen, the situation is very different for the smaller countries which attempt to develop manufacturing industries of their own, without possessing any special advantages for a particular type of manufacture. These smaller countries, save in a few industries in which small scale production is still economic, are placed at a disadvantage over the whole field of manufacturing industry. They may succeed in retaining their industries by erecting higher tariff barriers, but only at the cost of their own consumers. The great nations, on the other hand, developing not complementary but the same industries each within its national frontiers, all want to produce on the largest possible scale in order to secure the lowest possible costs. They therefore compete more and more intensely one with another for a share in the markets which still remain open ; and their conflict of interests in these markets generates Economic Imperialism as an almost inevitable consequence.

The Need for Large Economic Units. What is clear, however, is that the larger countries do possess, in terms of costs, a considerable advantage, and that, in relation to modern methods of production, small countries with high tariff barriers set up around them are not merely at a disadvantage but constitute a world nuisance. If advantage is to be taken of the benefits of modern productive technique, economic units must be very large indeed. But the world has not yet discovered any way of reconciling the division of its area into very small political units with the maintenance of free areas of exchange on a much larger scale. If

Europe is to get anything like the full benefit which its potential productivity makes possible, either the existing small States will have to be merged into larger political units, or these small political units will have to group themselves into larger economic units on a basis of free exchange of goods across national frontiers. There is no reason why the creation of these larger economic units should interfere in any way with sane political nationalism, any more than the existence of separate States within the federal structure of the United States or of the U.S.S.R. interferes with the freedom of industrial development over these vast territories.

Given larger economic units, the world will be far freer than it is to-day to take full advantage of the abundant productive resources at its command ; but there will still remain the problem of adjusting the economic relationships between these larger units of production. It seems to be inevitable that, between the great manufacturing countries of the world, there will be in the future less exchange of goods in proportion to total output—less exchange, that is, not absolutely, but relatively. Each large economic unit will tend to become in a relative sense more self-sufficient than before ; and the exchange of goods between these large units will take the form more of highly specialised products and of services than of standard industrial commodities which can be equally well manufactured within the borders of any of the groups. I do not mean that the mutual exchange of staple commodities even between great manufacturing countries will cease to exist, but only that it will become relatively less important.

But what of the countries which are exporters chiefly not of manufactured goods but of foodstuffs and raw materials ? What under these changed conditions will be their relationships to the great manufacturing nations ? These countries fall roughly into two groups—those which are capable within the predictable future of developing large-scale manufactures of their own, and those which are likely to continue for a long time ahead to concentrate mainly on

the production of primary commodities. Canada belongs obviously to the first type, Malaya and the Dutch East Indies obviously to the second ; it is far harder to predict the economic future of either Australia or the Argentine and Brazil. Australia is indeed relatively ill-equipped for a high degree of all-round industrial development ; for she is too remote and her home market too small to achieve this on sound economic lines. She may attempt it none the less, but only behind a high tariff wall which will seriously increase the cost of living of her own people. South America, on the other hand, is obviously far more capable of economic development ; but she lacks the resources of coal and iron on which Europe and the United States have built up their manufacturing supremacy. South America will probably become more important and self-sufficient as a producer of textiles, and will tend to export more of her primary products in a semi-manufactured state. But she will continue to depend on the rest of the world for coal and iron and for a wide range of capital goods for the production of which local supplies of coal and iron are essential.

The World's Open Markets. This points to the likelihood of increasing severe competition in the South American markets between the exporters of the United States and Europe, especially Great Britain. For South America is the richest potential market that is likely to remain open for the export of the products of the heavy industries. Africa, which is also likely to remain for a long while chiefly an exporter of tropical primary products, has been during the past half century the area in which the rival Imperialisms of the European nations have clashed to the greatest extent. In 1880 the European possessions formed hardly more, except in the South, than a fringe of settlements round the coast ; but between 1880 and 1914 practically the whole continent had been partitioned among the European Powers. The economic results of this partitioning have so far been for the most part unsatisfactory ; and Africa still

accounts for only a very small proportion of the total foreign trade of the world—less in 1913 than 5%, while only 3% of the total world production of foodstuffs and raw materials is assigned to the African continent. Africa, however, obviously possesses vast potentialities of economic development; for the demand for tropical produce is likely to increase very rapidly as the world's standard of living rises. It is probable that in the next few decades the African market will come to be vastly more important both for consumers' and producers' goods to the developed nations of the world; and, although there are now no native territories left to annex, imperialist rivalries are likely to continue and the different parts of the continent to be developed less in accordance with their own needs and potentialities than with the interests of the various Powers under whose domination they are.

The growth in the world of the principle of large and developed economic units, each equipped with largely the same range of manufacturing industries and each eager to find markets outside its own system for the disposal of its surplus of both producers' and consumers' goods, therefore threatens to perpetuate on even a more menacing scale the imperialist rivalries which served as a prelude to the war of 1914. In these circumstances, the great imperialist groups must either come to terms one with another or live under the perpetual menace of further wars—with the third alternative of changing their spots, and ceasing to be imperialist in a sense that threatens world peace. In determining which of these things is to happen three countries are likely to have the commanding say—Great Britain, the United States, and Soviet Russia. Continental Europe apart from Russia might indeed be no less influential than these three if it were able to settle its own internal differences and realise Briand's dream of the United States of Europe; but for a moment there is little enough sign of any such unification, despite the overwhelming economic arguments in its favour. Europe divided against itself is, of course, a force not promoting the solution of the world's problems, but

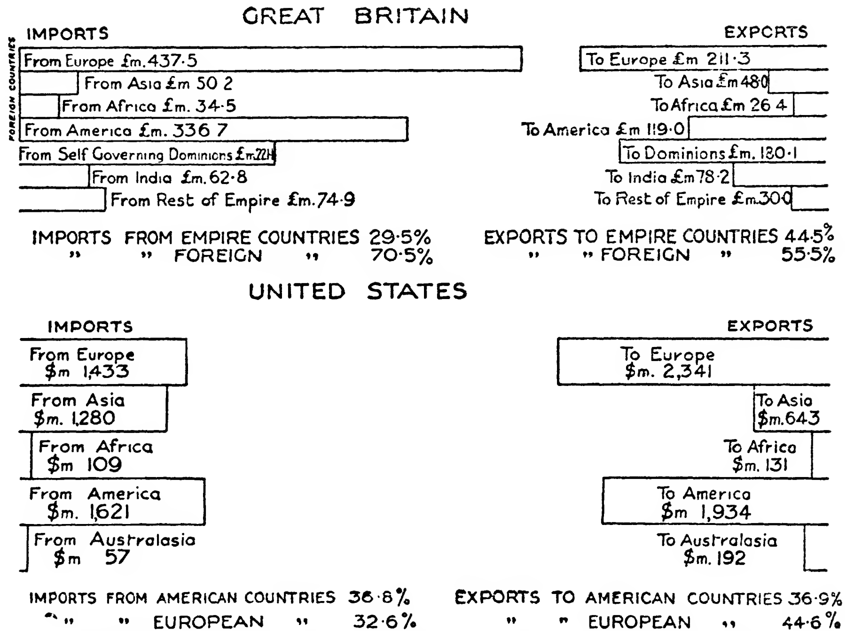
holding the world back from solving them by keeping it in a perpetual turmoil.

§3. THE BRITISH EMPIRE

GREAT BRITAIN occupies the key position because of the British Empire. There has been much talk of late years of constructing out of the Empire an economic unit which will render Great Britain independent economically of the rest of the world, and put her in a position to snap her fingers at the dissensions and calamities of Europe or the threatened loss of extra-imperial markets. But this vision of an economically unified Empire is most unlikely to be realised in fact ; and if it were realised its achievement would be a disaster for the world as a whole.

The British Empire, for the purpose of considering the possibilities of its unification, falls into three main divisions, apart from Great Britain herself—the great self-governing Dominions, India, and the Crown Colonies and dependencies. Discussion of imperial economic unity has often been concentrated mainly on the relations between Great Britain and the first of these three groups, but has sometimes also included consideration of the relations of Great Britain with her great colonies and dependencies. It has seldom taken much account of the position of India. Let us discuss it briefly as it affects each of these groups in turn.

The idea of a close economic unity, based on some approach to Empire Free Trade, between Great Britain and the self-governing Dominions has found vociferous support from a section of opinion in Great Britain itself, but almost none in the Dominions. Its British advocates have foreseen the possibility of so great a development of the Dominion markets as to afford an adequate outlet in the future for Great Britain's whole exportable surplus of manufactured goods. They have produced fantastic maps of the potential population of empire countries, based on comparing the areas of the Dominions with those of the most densely



BRITISH AND U.S.A. IMPORTS AND EXPORTS, 1929.
Sources and Destinations Classified.

populated parts of Europe, and then assuming that Canada and Australia are capable of becoming no less populous in a measurable space of time. They have then assumed that these vast and densely populated areas will continue to specialise in the production of primary commodities such as Great Britain needs to import, and will be content to draw the greater part of their manufactured supplies from Great Britain. What, however, is certain is that, if the Dominions are capable of absorbing population to anything like the extent suggested, they will also be capable of developing manufacturing industries of their own on a corresponding scale. Canada, which has the greatest capacity of all the Dominions for sustaining a largely increased population, is doing this already to a considerable extent. But it is fantastic to suppose that a country like Canada, which is seeking behind a tariff wall to develop a balanced economic system similar to that of the United States, will consent to throw down her tariffs so as to admit British goods free of duty. She may indeed consent—if Great Britain can offer her a satisfactory *quid pro quo*—to give British goods a larger tariff preference than at present, or even, in certain exceptional cases, to enter into arrangements for the bulk purchase of British coal or even British steel. But such increased preferences are far more likely to be given by raising still further the duties on foreign imports than by lowering the duties imposed on British imports ; and they are most unlikely to be accorded on any terms which will prevent Canada from developing her own industries as fast as she thinks they can be developed on an economic basis. There may be rather more possibility of some reduction in the exceptionally high tariff now in force in Australia, because of Australia's less advantageous position for increasing her population or widening the range of her industrial production. But it is fantastic to think of even Australia as admitting British goods free of duty, or allowing her own industrial development to be held back in order to give Great Britain a larger preference.

Is an Empire Unit Possible? The Dominions unquestionably mean to go on developing their own industries, and to exclude British as well as foreign goods to any extent that may be necessary for this purpose. Nor can Great Britain, for her part, offer them terms that are likely to make them change their minds. A simple instance suffices to make plain the effectual objections to the conception of imperial self-sufficiency. Great Britain at present imports about five and a half million tons of wheat a year; and her demand is more likely to fall off than to increase—for the consumption of wheat per head of population in the more advanced countries is tending to go down. Even if Great Britain bought no wheat at all outside the self-governing Dominions—even from the Argentine, which is at present one of her principal suppliers, or from Russia—she would be unable to absorb the present exportable surplus of wheat from the Dominions even in a year when the harvests were bad. In a year of good harvests she would be able to take less than half the total exports of wheat from Canada and Australia alone. Even, therefore, if Empire countries were given a monopoly of the supply of wheat to Great Britain, they would still have to dispose of a large part of their output in foreign markets, which would, of course, be also called upon to absorb the wheat from the Argentine, Russia, and other countries which Great Britain was refusing to buy. If Great Britain bought this Dominion wheat at a reasonable market price—at the world price, that is to say—it is difficult to see what benefit the producers in the Dominions would reap from the transaction, except that of having a certain market in advance for a part of their supply. For they would still have to dispose of the remainder of their products under conditions of competition at least as intense as those which now prevail. Moreover, there is clearly no reason at all to suppose that a monopoly of the British market would enable the Dominion producers profitably to grow more wheat than they are growing now, or accordingly offer them any advantage in return for which the Dominion Governments would be prepared

to grant the British industrialists a substantial preference.

It is doubtless true that, if Great Britain were to agree not merely to buy all her wheat from the Dominions but to buy at substantially more than the world price by granting to the Dominion producers a subsidy similar to that which the British wheat grower is now to receive, the Dominions might be prepared to give the British industrialists a *quid pro quo*. But any such *quid pro quo* would have to be paid for by the British consumer. It is possible to subsidise the British wheat grower without much effect on the cost of living, because home grown wheat forms so small a part of the total supply. But a subsidy applied to all wheat consumed in Great Britain would be a very different matter ; and it is difficult to conceive of the British electorate as waxing enthusiastic in such a cause.

Wheat is doubtless an extreme example of the absurdity of the idea of imperial self-sufficiency ; but there are other grounds for deeming the idea absurd. There had been in the years preceding the slump a great increase in the total value of the foreign trade of the British Dominions ; but quite naturally, as the Dominions increased their production of a fairly narrow range of staple commodities, they were coming to sell more of their output in foreign markets and less in Great Britain. The British exporter was coming to depend for a larger percentage of his sales than before the war on Empire markets ; but the Dominion exporter was making an increasing proportion of his sales to foreign consumers. Accordingly the Dominions would be most unlikely to look with favour on any project which, by involving them in a refusal to purchase goods from foreign sources, would jeopardise their expanding trade in the foreign market.

Of course, the great British Dominions differ considerably to-day in the intimacy of their economic connections with Great Britain. Australia buys a far higher proportion of her imports from Great Britain than Canada, which near neighbourhood thrusts into very close economic connection with the United States. New Zealand depends very largely

on the British market for her export of foodstuffs, and buys a very high proportion indeed of her total supplies from Great Britain. In her case something like Empire Free Trade might be a possibility, if her case could be taken alone ; but that is only because, in her case, the thing largely exists already. In the case of Canada the very idea is obviously absurd, both because of the inevitability of the further growth of industries on Canadian soil, and because of the close economic connection between Canada and the United States.

India. What then of India—the second great group among those of which the British Empire is composed—with a far vaster population than all the rest of the Empire put together ? Of all Indian exports Great Britain in a normal year buys substantially less than a quarter. It is true that British exports form a far higher proportion of Indian imports ; but it is clearly out of the question for Great Britain to offer India a market for the major part of the goods which she needs to export. India's natural market is and will be more and more in the Far East ; and it would clearly be contrary to her interests to enter into any sort of exclusive trading relations with Great Britain in such a way as to prejudice the development of her trade with China, Japan and other Asiatic countries. Great Britain, it is true, still for the moment controls the government of India, but even so no Government of India could venture to force an economic policy based on imperial isolation. Despite the protests of the Lancashire cotton industry the Indian Government has already had to acquiesce in the imposition of a tariff on British cotton goods, and India's dependence on British exports is likely to become a good deal less exclusive than it has been hitherto. The idea of India as part of a self-contained British Empire is even more fantastic than the same idea applied to the self-governing Dominions.

The Crown Colonies. We come finally to the Crown

Colonies and Dependencies. In most of these there is for some time to come no likelihood of a substantial development of native manufacturing industry. They are, and will remain for some time, chiefly producers of primary goods. There is no doubt that there exist among the non-self-governing parts of the British Empire—in Nigeria for example—vast undeveloped economic resources of raw materials, as well as great possibilities of increasing the output of tropical agricultural produce. The development of these areas is therefore capable of giving the British industrial system valuable supplies of raw material for use in manufacturing production ; and there is room for a great expansion in their consuming power as their production of raw materials for the world market goes up. It is a possible policy, and one quite consistent with the past history of colonial expansion, for Great Britain to endeavour to monopolise these advantages for herself ; but it is a policy fraught with great danger to the world's future, and fortunately one likely to encounter many obstacles to its realisation.

For one thing this policy of colonial exclusiveness cannot be applied to those territories which were handed over to Great Britain by way of mandate under the Peace Treaty ; for in these cases the policy of the " open door " has been guaranteed by the treaties themselves, and the jealousies of the signatory powers are likely to ensure the observance of this provision at any rate to a considerable extent. Great Britain, therefore, if she set out to develop her African territories on the lines of an imperialist trading monopoly, could not include within any such scheme Tanganyika or the other colonies which she acquired from Germany at the end of the war. Nor could she enforce her policy on the Union of South Africa or on territories directly or indirectly under its control or influence. This difficulty, especially in the case of Tanganyika, has already arisen in connection with proposals for the unified administration of British territories in Eastern Africa ; and no way of surmounting it has been discovered. There is indeed no

corresponding obstacle to the adoption of a policy of exclusiveness in those territories which are under British control without a mandate, and do not enjoy self-governing institutions. But it would be difficult in practice to apply the policy of the " open door " in one territory and that of the " closed door " in others immediately contiguous to it.

Nor can there be any doubt that, even if this policy were possible, it would be bad for Africa and the world as a whole. For if one imperialist country pursues it, that only encourages others to do the same ; and the real need of Africa is for unified development with as few internal barriers and obstacles to the freedom of trade as possible.

§4. POST-WAR TARIFFS IN EUROPE

We have seen in the previous section that one of the most important legacies of the war has been both the raising and multiplication of tariff frontiers, owing to the creation of a number of new States in Europe and to an intensified policy of economic nationalism throughout the world. It is now time to examine more closely the reasons which induce countries to adopt tariff policies or in other ways to restrict the free movement of goods across their frontiers, and the effect which this policy has had upon post-war conditions in Europe and in the world as a whole.

Some tariffs are regarded as being made for purposes of revenue only, and not for the protection of any native industry. These may be rapidly dismissed. When a tariff is levied on a commodity that cannot in the nature of things be manufactured within the country imposing it, or could be manufactured only at so extravagant a cost that no one would seriously consider doing it, the purpose cannot be protective in any direct sense. Any such tariff is bound to raise the cost of the commodity to the consumer, though not necessarily to the full amount of the duty. Its effect must be therefore to discourage consumption ; but this will occur in very different degrees according to the nature

THE RISE OF EUROPEAN TARIFFS, 1925-1929

	Estimated Level of Tariff Duties in 1925 % of value of goods	Estimated Level of Tariff Duties in 1929 % of value of goods	Rise from 1925 to 1929 per cent.
Austria . .	12	14	17
Belgium . .	8	12	50
Czechoslovakia .	19	18	−5
Denmark . .	6	10	67
France . .	12	16½	38
Germany . .	12	15½	29
Holland . .	4	8½	112
Hungary . .	23	18½	−20
Italy . . .	17	16	−6
Poland . .	23	21	−9
Spain . .	44	25	−43
Sweden . .	13	13½	4
Switzerland .	11	12	9
Great Britain .	4	8½	112
Yugoslavia . .	23	19	−17

NOTE.—The above table does not show the great increases of tariffs since 1929, as it is not yet possible to express these by means of index numbers. Nor does it, of course, show the effects of prohibitions and restrictions of imports by other means than tariffs. These have in fact become during the past two years even more important than tariffs as barriers to international trade (e.g. especially the restrictions on foreign exchange).

of the commodity on which the tax is imposed. Thus in the United Kingdom tea is a necessity, whereas coffee is a luxury. The demand for tea is therefore relatively inelastic, and a change in its price owing to the imposition of a duty is more likely to bring in revenue to the Exchequer than seriously to decrease its use. On the other hand a tax on coffee will serve largely to decrease consumption by inducing the people to consume alternative beverages. A tax on coffee, to the extent to which it does bring in revenue, will fall mainly on luxury expenditure and on the richer sections of the community, whereas a tax on tea will be borne especially by the poorer classes. Tariff duties for revenue purposes can thus be divided into two groups, according as they are levied on luxuries and likely to be paid by the rich and to check consumption, or levied on necessaries and likely to be paid mainly by the poor without much effect on consumption, unless of course there is a cheaper substitute commodity readily available.

Revenue Tariffs and Protection. Revenue tariffs are of very little use for the purpose of raising money for the State unless they are levied on necessaries as well as luxuries ; for the more a tax reduces consumption the less of course it yields, and the point may easily be reached, as in the case of wines, at which a raising of the rate of duty will so decrease consumption as positively to lower the total yield of the tax. Revenue tariffs tend, therefore, to be inequitable in their incidence, in that if any substantial amount of money is to be raised by them they have to fall most heavily on the poor.

The name " revenue tariff," however, is sometimes attached to duties of a quite different sort—for example to duties levied at a low rate on a wide range of commodities, including goods which are capable of being produced within the country. In these cases it is alleged that the tariff is too low to afford any substantial amount of protection to the home manufacturer ; and, while it is admitted that it must have *some* protective effect, it is held that this can be

disregarded, and the tariff treated as an instrument for the raising of public revenue. Many of the less developed States rely largely on tariffs which are in effect imposed mainly for revenue purposes. For income tax, the chief form of direct taxation in the more advanced States, is difficult to assess and collect in less developed communities. Even Great Britain had no income tax until the Napoleonic Wars and repealed it for some time after 1815. But it is by no means true that when a tariff is imposed mainly for the purposes of revenue its protective effect can be disregarded. In fact both motives are present in the formulation of tariff policy in practically every country. The more, however, a tariff is levied for purposes of revenue, and the less for protective objects, the more equal the rates of duty on different classes of commodities are likely to be. Tariffs imposed at very different rates on many different classes of goods have practically always a protective object in addition to the object of raising revenue. It is indeed sometimes proposed to levy a tariff at a flat rate on a wide range of commodities neither mainly for revenue nor for the purpose of protecting any particular industries, but rather with the object of redressing an unfavourable balance of trade by reducing the consumption of imports. A so-called "revenue tariff" of this kind was advocated by Mr. J. M. Keynes and certain other economists in Great Britain before the crisis of 1931. Mr. Keynes indeed, while he called his proposal a revenue tariff, actually suggested that the State should derive from it no net revenue at all, but should use the proceeds for the purpose of granting a bounty on exports from Great Britain in order to redress the adverse effects caused by the over-valuation of sterling under the terms of the British return to the gold standard in 1925. But it is clearly a misnomer to describe a proposal of this order as a revenue tariff. It is in its essence protective, though its object is not to protect any particular industry, but to redress the balance of imports and exports as a whole. It is in effect a highly unscientific kind of low protection, paying no regard to the economic consequences of each particular duty. The only

case for it that can be made out at all really went by the board when Great Britain decided to suspend the gold standard ; for it was in essence a financial measure dependent on the pound sterling being still overvalued in terms of gold.

To some extent the raising of tariff walls in the world since the end of the war can be attributed to the need of the various States for a larger public revenue. Those States which took part in the war had emerged from it heavily burdened with public debts, and therefore requiring additional taxes in order to meet charges for interest and sinking funds. The nations which were neutral in the war are not indeed similarly placed ; but in their case too the level of public expenditure has in most cases risen owing to an advance in standards of government and in the social services, and it is apt to seem easier to raise the additional revenue needed by indirect than by direct taxation. Most countries in the world are used to tariffs ; and the raising of tariff duties, which can be represented as a necessary measure for the protection of industry, therefore causes far less emphatic protest than an attempt to increase the yield of direct taxation. This is both because the rich are in most countries more articulate and more influential than the poor, and also because it is far easier to realise that one is paying a direct than an indirect tax. States in need of revenue are therefore under a strong temptation to resort to a protective policy, and to levy duties especially on those classes of goods that are likely to continue to come into the country in considerable quantities even over a high tariff wall.

The Growth of Protection. It would, however, be a mistake to attribute the general raising of tariff levels throughout the world mainly to this increasing need for revenue, although this has undoubtedly made the Governments of the various countries far readier to listen favourably to protectionist arguments. The rise in world tariffs is primarily due to a desire to protect home production

against imports, and to secure for the home producer the market at home for as large as possible a part of his produce.

Since the conclusion of the war there have been several successive phases of world tariff policy. In the period immediately after the conclusion of hostilities two motives predominated—discrimination against the imports which were expected to flow in from the late enemy countries, and the desire to prevent the extinction and decay of industries established or extended during the war period. These desires led during 1919 and 1920 both to the imposition of new emergency tariffs and to the adoption of a widespread system of restrictions on imports and exports under emergency powers for the most part secured during the war. To a great extent these provisions were meant to be temporary ; and it was hoped that as world economic conditions returned to the normal the great mass of prohibitions and restrictions could be rapidly removed, and tariff duties stabilised at a not excessive level. But the world, instead of settling down, plunged into a period of intense monetary instability. On the one hand the great deflation of 1920–21 cause a very sharp fall in the world price level measured in terms of gold and in the price levels of countries which were on or near the gold standard ; and on the other a number of countries passed through a period of intense currency inflation, which caused their internal prices to rise sharply, but not nearly so sharply as the external value of their currencies fell. The exports of these countries could thus be purchased abroad at an even lower gold value than the exports of countries with deflated currencies ; and this bonus on the exports of the countries whose money had depreciated heavily in external value provoked retaliatory measures in order to stop what was called "exchange dumping." A number of countries, such as Canada, gave their Governments power to impose special duties at varying rates on goods consigned from countries whose money had greatly depreciated in value ; and apart from this there was a general tendency to push tariff rates

upwards in an attempt to counteract the instability of the foreign exchanges. Thus the uncertain behaviour of money gave a fillip to economic nationalism, and tariff rates throughout the world, instead of varying as the world price level was reduced, remained high and in some cases became higher and higher as the war receded further into the background.

The World Economic Conference. This was the position when the World Economic Conference met at Geneva in 1927. Practically all the leading countries sent delegates to this conference, and practically all the delegates were in agreement on the general principle that the existing tariff rates were far too high and ought to be drastically reduced. But, while each country was eager to persuade the others to reduce their tariffs, very few of them showed any willingness to bind themselves to reduce their own. The World Economic Conference had therefore to content itself with a general declaration in favour of tariff reductions, and with the advocacy of certain important but secondary changes in tariff policy. It urged, for example, the necessity of more uniform systems of customs classification throughout the world and especially in Europe, in order that manufacturers might at least know what rates of duty their goods would have to pay at each different frontier ; and some progress was made as a result of the conference in reducing the complexities and contradictions of tariff classifications in different countries. In the second place, the World Economic Conference agreed upon a Draft Convention aiming at the removal as far as possible of all prohibitions and restrictions on imports otherwise than by way of tariff. This Draft embodied a large number of exceptions and reservations made by the various States, including especially an exception for any goods in respect of which there existed a State monopoly of trade. But its intention was as far as possible to get rid altogether of the method of regulating imports by means of prohibitions, quotas and licensing systems, while leaving each country

free in the framing of its national tariff policy. The Convention, though accepted by a large number of States, has never been finally ratified by most of the leading Powers ; and since the beginning of the world slump there has been a pronounced movement for the revival of restrictions and prohibitions on imports of various classes.

At the time when the World Economic Conference met there did appear to be some reasonable prospect of a reduction in world tariff levels ; for most people thought in 1927 that the economic difficulties of the post-war world were in process of being rapidly overcome. Many countries had returned to the gold standard, and more were in process of doing so ; and the general expectation was that within a brief period the stability of the exchange value of most of the world's currencies would have been restored. The reason for exceptional protective measures directed against "exchange dumping" would therefore disappear ; and the experts at Geneva thought it would then become possible to induce the Governments of the world to see the folly of maintaining in almost every country tariffs so high as to interfere seriously with the expansion of the total volume of international trade.

The Proposal For a Tariff Truce. The International Economic Conference left in being a Committee to supervise the carrying out of its recommendations, and to report periodically on what was being done ; but in the next two years, despite the maintenance of world prosperity, progress with the reduction of tariffs was so slow as to be almost non-existent, and at any rate did no more than keep pace with the slowly falling level of world prices. The negotiations for a Tariff Truce, instituted on the initiative of the British Labour Government in 1929, were an attempt to find a new basis for continuing the work instituted by the Geneva Conference. The new proposal was that all countries should at least bind themselves not to increase their tariff rates or to impose new duties for a period. The object was to give time and favourable conditions for the negotiation of

multi-lateral agreements for lower rates of duty. It was, however, obvious from the outset that a number of countries, including France and Italy, would be very reluctant to give any guarantee not to raise their rates, and that the majority of other countries were likely to make any guarantee conditional on agreement by the rest. It was evident too that in every country the interests protected by the national tariff policy would bring very heavy pressure to bear on the Government not to agree to any tariff reductions which would affect them. Moreover, it was not easy to find a satisfactory method of beginning to negotiate about the form which reductions should take. Any attempt to make a start by considering the tariffs in existence on a particular commodity, such as coal or steel, was at once met with the objection that in each national tariff it was impossible to isolate the duty levied upon one class of goods from the duties levied upon others, and that it would be unfair to reduce the protection afforded, say, to the steel industry while leaving the duties on other classes of imports unchanged. On the other hand, when it was attempted to discuss tariff policy generally, a different set of difficulties made their appearance, connected especially with the working of what is called " most favoured nation " clause.

The Most Favoured Nation Clause. The most favoured nation clause is a clause which appears in somewhat different forms in a very large number of the commercial treaties between country and country. In effect it guarantees to each of the signatories that the other will grant to its manufactures, subject to any stated exceptions, conditions of entry into its markets at least as favourable as to the manufactures of any other country. If then, any country which has embodied most favoured nation clauses in its commercial treaties proceeds to negotiate with any other single country, or group of countries, a bilateral or multilateral treaty reducing the duties on any or all kinds of goods, the most favoured nation clause binds it to accord the same preferential treatment to all other countries with

which it has entered into treaty relations embodying the clause. In the case of Great Britain, which has made the most favoured nation clause one of the principal instruments of commercial policy in the past, an exception is now always made for Empire countries, and Great Britain does not undertake to extend any preference which she gives to Empire producers to any other countries. If, however, she did desire to extend a similar preference to any country outside the Empire, such as the Argentine, the effect of the most favoured nation clause would be that the great majority of other countries would automatically secure at the same time the full benefit of the preference. In the case of the United States the form given to the most favoured nation clause is a good deal less extensive than this ; and, while the United States is always prepared to demand her full rights under the clause from other countries, she is somewhat narrow in her interpretation of the reciprocal obligations falling upon herself.

The most favoured nation clause, at the time when it was first designed, was intended as an instrument for the promotion of freer trading conditions ; for its effect was, whenever a liberal trade arrangement was made between two countries, to extend the influence of this arrangement over a wider field. But it is doubtful whether the clause really exerts this liberalising influence to-day ; for the necessity of extending automatically to a large number of other countries any concession that may be made for special reasons to a single country tends to make all countries reluctant to make any special concessions at all, even where a case for them can be fully made out. The most favoured nation clause therefore tends to stand in the way of the making of bi lateral and multi-lateral agreements among neighbouring States for a mutual reduction of tariffs ; and this is most serious in its consequences on the tariff policy of the new States of Central and Eastern Europe.

The World Economic Conference of 1927 and the Tariff Truce meetings of 1929 and 1930 had therefore to consider whether and how far the policy of the most favoured nation

clause ought to be modified for the purpose of making easier the conclusion of conventions between particular States for the mutual lowering of tariffs on one another's goods. Especially it had to be considered how the most favoured nation clause would react on proposals for actual Customs Unions based on complete mutual free trade between two or more countries. When the Austro-German proposal for a Customs Union was advanced in 1931, it was argued that the complete unification of two customs areas would not carry with it any obligation in respect of similar treatment to other countries. Indeed, any other view would really make nonsense of the proposal ; for it would mean the concession of complete free trade without any reciprocal concessions by other countries. But the Austro-German Union was vetoed by France, which feared that economic unification of Austria and Germany might lead to political unification ; and the question, as it affected the most favoured nation clause, was therefore never decided in this case. It has come up again, however, in connexion with the recent proposals for complete or partial Customs Unions among the Danubian States and in Eastern Europe generally, and also in connexion with proposals affecting the Baltic States and with projects of bi-lateral or multi-lateral treaties in other areas. It is by this time clear that the policy of most favoured nation treatment, if it is retained at all, will have to be very greatly modified, unless it is to serve as a positive obstacle to the lowering of European tariff rates.

Europe and America. Especially do the countries of Europe object to having to concede most favoured nation treatment to the United States, despite the very high level of the American tariff on manufactured goods. The most favoured nation clause is included in a large number of American commercial treaties ; and in connexion with any bi-lateral or multi-lateral agreement for the lowering of duties the United States never fails to claim the benefit of it. This constitutes indeed the strongest of all arguments for the modification of the clause. Great Britain, which also

derives large benefits from it, was disposed until recently to stand firm for its retention in its old form. But the obstacles which it puts in the way of tariff reductions by way of mutual negotiations are now so widely realised that British policy in this respect is undergoing a progressive change.

Types of Tariff Duty. The Tariff Truce negotiations were begun before the onset of the world slump; but what chance they had of success was completely wrecked by the slump. It is true indeed that the great fall in prices which accompanied the slump ought to have made possible a corresponding reduction in those tariff rates which were fixed on a specific basis—as it did actually reduce the amount though not the proportional burden of *ad valorem* tariffs. These phrases need perhaps a word of explanation. An *ad valorem* duty is one that is levied at so much per cent. on the estimated value of the goods concerned—say 33% as in the case of the McKenna duties in Great Britain. A specific duty on the other hand is a fixed money tax levied on each imported commodity or on each pound or ton of goods. As prices fall, *ad valorem* duties fall with them; but specific duties become heavier in their incidence, just as they became much lighter during and after the war while prices were rising fast. Some countries adopt the one system in assessing their tariffs and some the other; while yet others have a mixed system of *ad valorem* and specific duties. This difference of policy has introduced an added complexity into the tariff situation during the years of rapidly fluctuating prices since 1914. Thus, whereas, France, Germany, Italy, Sweden, Brazil and the United States use mainly fixed duties, Great Britain, India, New Zealand and Canada largely employ the *ad valorem* system. Countries which use the former method have actually increased to a considerable extent the real amount of protection accorded to their industries in recent years, even where they have not changed their rates of duty at all; whereas some countries which have reduced nominal duties have made no real reduction in relation to the value of the goods. On the other hand

countries using the *ad valorem* system can increase the real protection afforded only by an actual raising of rates.

Falling prices ought, we have seen, to be accompanied by at least a corresponding reduction in tariff levels, if the amount of protection is to remain unchanged. But in effect, when falling prices are due to trade depression, the producers in each country are apt to redouble their efforts to secure increased protection in order to make surer at least of their home markets in face of a falling off in foreign demand and of the threat of dumping from abroad. Accordingly in the world as a whole tariff rates, even in terms of money, have tended to rise since the coming of the world slump ; and the real increase in relation to the value of goods subject to duty has been very much greater. This increase in the real level of tariffs has by no means been confined to manufactured goods. Especially in Europe, there has been in recent years an even more pronounced tendency in the direction of increased protection for agriculture. Countries such as Germany have desired to reduce as far as possible their dependence on imported foodstuffs by increasing the home supply ; while the more agricultural States of Eastern Europe have desired to protect their home markets against cheap foodstuffs from the great producing areas outside Europe. There has been not only a rise in the level of agricultural tariffs, but also a widespread adoption of new restrictions on the importation of agricultural supplies. Often this has been accompanied by a raising of the protective duties on imported manufactures ; for the agriculturist and the industrialist have struck a bargain whereby each has agreed to concessions to the other in return for higher protection for himself. Thus the world depression has tended strongly to accentuate the movement towards economic nationalism, and to foster by the simultaneous raising of tariffs on foodstuffs and manufactures the policy of national self-sufficiency in each country.

Customs Unions. This policy is, however, at least in the case of the smaller States, merely ridiculous, and destructive

of the economies of large-scale production ; and there is a growing realisation of the need for increasing the areas over which goods are allowed to move freely, even if high tariff barriers are maintained round the borders of these large unified areas. Hence the movement to promote Customs Unions and bi-lateral and multi-lateral agreements for mutual tariff reductions. But, as we have seen, the practical progress made by these movements has been so far very slow indeed, for in each country the pressure of the interests demanding higher protection has been as a rule stronger than the more diffused demand for a greater measure of international co-operation. Even if it can be demonstrated that costs of production could be decreased by increasing the size of the free trade market, this may not be at all convincing to the producer in a particular country ; for what he cares about is not his absolute cost of production, but the difference between this cost and the price at which he is able to sell. He is often afraid that if a Customs Union or bi-lateral agreement is negotiated with a neighbouring country the effect of the competition of that country's products with his own will be to lower prices by more than his cost can be reduced through the extension of the market. Thus the egoism of manufacturers, backed up often by the fear among the workers of loss of employment in their accustomed trades, puts serious obstacles in the way of even those proposals for freer trade which seem to have an unanswerable economic case behind them.

It is in fact clear enough that nothing short of sheer desperation is likely to lead the Governments of most of the European countries to adopt any effective measures for the reduction of their tariffs. As long as they can carry on somehow, even in face of the slump, they are more likely to raise than to lower their tariff barriers, and to impose than to remove restrictions on imports ; for each raising of the tariff and each fresh restriction can be represented not only as a necessary measure of protection for the home producer, but also as an indispensable condition of restoring the balance of trade. Only when countries become

convinced that, despite all the restrictions they are able to impose, they cannot carry on at all under the existing conditions are they likely to listen seriously to proposals for economic unification over a wider area. The Danubian and certain other countries of Eastern and Southern Europe may now have reached this point—and, what is more, the great Powers which are their creditors may have reached it for them. But even so there remain great obstacles in the way of economic unification of these territories ; for it is impossible to disentangle economic from political considerations, and which countries should unite with which and upon what terms and under what leadership of the greater Powers is a question on which there are apt to be widely divergent views. France, for political reasons, will have nothing to do with an Austro-German unification but desires to create in Eastern and Southern Europe a block of States under her own effective influence. On the other hand, neither Great Britain nor Germany nor Austria desires to see a French political hegemony of Europe ; and accordingly, when the great Powers meet to discuss economic questions there is always an undercurrent of rival political ambitions to be reckoned with. But sooner or later these difficulties must be overcome, and Europe released from her present bondage to the economic nationalism of countries far too small to sustain a self-sufficing productive system. The only question is whether the point of unification will be reached before there has been a positive breakdown of European economic affairs, or whether complete breakdown and chaos will have to precede the building up of a new order.

§5. GREAT BRITAIN'S TARIFF POLICY

THE MOST startling lapse into economic nationalism in recent years has been that of Great Britain—hitherto the staunchest advocate of Free Trade and the great country most dependent on external commerce for the means of life. There

had of course been long before the war an ardent advocacy of protection, then called Tariff Reform, in Great Britain, often mingled with the demand for an extensive system of Empire preference, in order to build up the British Empire into an effective economic unit. But, although this policy was sponsored by the great majority of the Conservative Party, it never stood, before 1914, any real chance of adoption : for Great Britain was still far too comfortable under the free trade system to run the enormous risks of a change in her economic structure. Her exports were still expanding fast, and lost markets in one area were being more than replaced by the development of new markets elsewhere. The war, however, served largely to change men's outlook ; and the first breaches in the British free trade system were made during the war largely as discriminating measures against trade with the enemy countries after the conclusion of peace. Great Britain, moreover, shared with other countries immediately after the war the desire both to maintain in existence new industries which had been brought into being or considerably extended since 1914, and to protect herself against the "exchange dumping" of goods from countries with heavily depreciated currencies. These desires were largely at the back of the " key industry," " safeguarding " and other protective duties imposed during the years immediately following the war ; but in the existing state of British political opinion these new forms of protection had to be confined to a relatively narrow range of goods, and to be put forward as purely temporary expedients. There was no conversion of the British public to a general protectionist policy ; and not only had duties on imported foodstuffs to be definitely ruled out, but it was even found politically impossible to impose duties on imported steel or woollen goods, despite increasing pressure by British manufacturers to secure protection for these trades.

The continued hostility of public opinion in Great Britain to any policy of general protection was plainly demonstrated in the General Election of 1923, which resulted in the return to office of the first Labour Government in British history.

For, though the Labour Government had no clear majority behind it, and was compelled to depend upon Liberal support, the great losses sustained by the Conservative Party in the Election were clearly due to its demand for a free hand on the tariff issue. Even when the Labour Government was defeated, and the Conservatives came back to office at the end of 1924, the incoming Government had to pledge itself against the adoption of any general protective policy ; and during its term of office duties on imported steel and woollen goods, as well as on foodstuffs, were again repeatedly refused. Only the world crisis of 1929 made feasible the realisation of the Conservative dream of a general tariff policy ; and even then this policy had to be introduced by stages and on plea of a national emergency requiring exceptional measures in order to readjust the balance of trade. Without the support of the panic fears aroused by the crisis of 1931, not even the Conservatives could have ventured to introduce any measure of general protection.

The New British Tariff. But, as matters were, the so-called "National" Government of Mr. Ramsay MacDonald secured from the electors a "doctor's mandate"—in other words a completely free hand ; and the Liberals who had entered into the coalition found themselves dragged along at the heels of the Conservative Tariff Reformers. The inception of the protective system began with a measure aimed nominally at the restriction of "abnormal" imports of manufactured goods, and with a parallel measure restricting the importation of horticultural products. Under these Acts, power was given to the Board of Trade to impose exceedingly high protection—running up to duties of 100% *ad valorem*—and in fact duties of 50% were imposed. This, however, was only the first instalment of the new policy, and early in 1932 the "National" Government set seriously about the institution of a policy of all-round protection. Under the new Act passed early in 1932 practically all imported manufactured goods, and also a considerable

quantity of raw materials and foodstuffs, were made subject to import duties beginning at a flat rate of 10%, but subject to undefined increases to be settled subsequently on the advice of a special committee which was set up under the Act. This Committee has now prepared, and Parliament accepted, a general tariff imposing on most manufactured imports duties of 20% or more, and on luxury goods of 30% ; and the Government has also imposed, by separate action, new protective duties on imported silk and artificial silk. Power was further taken for the Board of Trade to impose discriminating duties upon products coming from countries which were regarded as guilty of "dumping" or of exceptional discrimination against British imports ; but it was understood that this last power was meant to be used rather as a basis for negotiation than by its actual exercise. At the same time the "National" Government introduced a Wheat Quota Bill for the purpose of protecting the British wheat grower, not by the imposition of a duty on imported wheat, but by the concession of a guaranteed market for the entire product of the British farmer at a price considerably above that of similar imports. It was further announced that the Imperial Economic Conference, due to be held at Ottawa in July 1932, would have under consideration a proposal for a Dominion Quota as well—in other words for a special preference to be accorded to Empire wheat in the British market. The effect of the wheat quota system, even as applied to the British farmer only and not to the Dominion producer, was equivalent to a high protective tariff, and involved for the British public a cost higher than that of a 10% duty on all imported wheat. Thus under the measures passed in the early months of 1932 Great Britain is committed to a protective system in respect not only of imported manufactures but also of one of her most vital foodstuffs. Apart from such essential raw materials as cotton, only meat among the leading commodities entering into British imports has so far been left free of duty, and it is now suggested that some sort of quota system may be applied to meat and other agricultural imports in the near future.

It is, of course, impossible to pass judgement on the new British protective system until it is known at what level duties are likely to settle down under the new Acts, and therefore until the Advisory Committee appointed under the Act has completed its reports to the Government. But there seems to be no doubt that it is intended to apply protection at a considerably higher rate than the 10% imposed directly by the Act itself—certainly at not less than 20% in the great majority of cases. Until 1931 Great Britain had levied import duties at a fairly high rate, but only on a quite small range of products. The new measures of 1931 and 1932 appear to have made her at one blow a thorough-going protectionist country.

The Balance of Trade. At the time when this change was made, the arguments for and against it were clouded by the obsession of British opinion with the temporary problems of the trade balance and the stability of the pound sterling. The "National" Government was returned to power largely by the votes of those who believed, rightly or wrongly, that the pound was in serious danger of losing most of its value; and protectionists on the morrow of the election based their case in public far more on the need for measures to redress the balance of trade than on the traditional protectionist arguments. But the immediate financial crisis in Great Britain had been definitely overcome for the time being by the end of 1931, not so much through the improvement in Great Britain's economic situation as through the worsening of the economic position in other countries. No one could pretend in the early months of 1932 that the pound sterling was in immediate danger of any considerable further depreciation. Indeed, the fear in informed circles was rather that it would rise too sharply owing to the distrust felt by the nationals of other countries in their own financial position. Accordingly the protectionist case had to be argued much more on the familiar grounds; but the "National" Government consisted so overwhelmingly of convinced protectionist Conservatives that the arguments

used did not greatly matter. For it was clear that a majority in Parliament was determined to push whole-hogging protection through in any event. Even so, the proposal to grant allround protection to British agriculture had to be approached with circumspection ; and in the case of wheat the Government preferred the method of quota and subsidy to that of the straight protective duty. But the point is that the protective system instituted in 1932 could clearly not be justified on grounds of financial emergency, but depended for its support on those arguments which had been current even before the emergency arose.

The protectionist case in Great Britain rests on the belief that protection can be used as a means of expanding both profits and employment. The protectionist argues that Great Britain is in a position to produce for herself a very large proportion of the goods which she at present imports. This applies to both manufactures and foodstuffs, but only to a much smaller extent to raw materials, for which a continued dependence on foreign supplies is to a great extent obviously unavoidable. The protectionist case is that if foreign manufactures are taxed, the British manufacturer will be able to use his privileged position in the home market so as to reduce his costs of production by spreading them over a larger output, and thus give the consumer as good service as he can get from imported commodities. At the same time, it is suggested that the British manufacturer, through his reduced costs, will be able to improve his position in the export markets, especially if he pursues the policy already adopted by Germany and other countries of " export dumping "—that is to say, of selling cheaper in any market in which competition is severer than at home. In the case of agriculture it is seldom suggested that the British producer will be able to sell his goods to the consumer as cheaply as imported supplies are now sold, and still to retain for himself an adequate profit ; but it is urged that Great Britain cannot afford to leave the great productive resources of her countryside unused, and that any additional burden laid upon the consumer through higher prices will

be more than repaid by the increased employment which the agricultural industry will be able to provide and the enhanced demand of the agricultural community for manufactured goods.

Semi-Manufactures and Finished Goods. On the other hand, it has to be remembered that a large part of what are called in the customs classification manufactured imports consists in fact of goods which are not ready for use, but are designed to be worked up further by the British manufacturer, often with a view to export—as for example when semi-manufactured steel imported from Belgium is used to make tin-plates for export to the United States and South America. A further considerable part of Great Britain's so-called manufactured imports consists of petrol, which will continue to be required in order to provide cheap transport facilities until and unless the production of oil fuel from British coal can be placed on a satisfactory commercial basis. The quantity of really finished manufactures that Great Britain imports is considerably less than the total of manufactured goods included in the Board of Trade Returns ; and there is considerable danger that taxes levied upon imports of semi-manufactures may react unfavourably on British exports of finished goods. Moreover, either taxes or subsidies in the interest of British agriculture are bound to raise the cost of living ; and this in turn is certain to give rise to demands for higher wages from the wage-earners. These demands may not be effective so long as the present depression lasts ; but they are certain to be pressed strongly as soon as conditions become more favourable to working-class action. Moreover, if Great Britain seriously restricts her demand for imports of foodstuffs and manufactures from the rest of the world, she can hardly expect to do this without some reaction on the demand for her exports. For Great Britain has been hitherto one of the greatest markets in the world ; and if she buys less from other countries they will not be able to afford to buy as much as before from her. It is therefore absurd to suggest that the

adoption of a protective policy by Great Britain is likely to stimulate British export trade. It is on the contrary certain to have in this field some depressing effect. It can be justified, if at all, only on the ground that it is likely to do more to stimulate demand at home than to decrease demand from overseas.

But in this respect Great Britain is most unfavourably placed for the adoption of a general protective policy. She has built up, on a basis of Free Trade, a very highly specialised industrial system, which depends to a greater degree than the industrial system of any other country on her ability to sell her goods in the world market. The change-over to a greater degree of self-sufficiency, based on protection for the home market, even if it could be brought about without ultimate loss, would involve a very great alteration in the structure of the British economic system. Old industries which have been built up mainly for export would have to be seriously reconstructed and reduced in size ; and their places would have to be taken by new industries catering exclusively or largely for the home market. In this process a considerable amount of the existing capital equipment of British industry would be bound to lose its value and a good many British workers would find their acquired skill in the declining export trades no longer of use. Moreover, a protective system would be likely to involve the loss of a large part of the *entrepôt* trade hitherto carried on at a considerable profit by British merchants, in favour of the direct consignment of goods from their country of origin to the country in which they are destined to be consumed. Very strong arguments are therefore needed if Great Britain's departure from her free trade position is to be economically justified.

Is Free Trade Dead ? It may, however, be held that a change in economic policy has been absolutely forced upon Great Britain by the changed conditions of the world markets in which she is trying to sell her goods ; for undoubtedly the economic nationalism which has pervaded

the world since 1914 has reacted with exceptional severity on the British economic system. This is not because British goods are in general subject to higher rates of duty than the goods of other countries ; for, on the contrary, in the great majority of markets Great Britain, on account of her free trade policy, has enjoyed most favoured nation treatment. It is because she depends in a very high degree on exports, and because her staple exports are precisely of those kinds which other countries have been endeavouring most to replace by the development of native manufactures.

It is undoubtedly true that, as industrialism develops in the Far East, the export market for the cheaper classes of British cotton goods is bound to decline. It is also true that the growing tendency for more and more countries to make themselves independent of foreign supplies for both iron and steel and woollen goods is mostly unlikely to be reversed, so that these industries as well as Lancashire's staple trade are not likely to be able to market so high a proportion of their product abroad in the future as in the past. Changes in the world market are bound to enforce upon Great Britain considerable changes in industrial structure ; and it is most improbable that she will ever again be able to export as high a proportion of the total product of her industries as before the war. The question is whether it is desirable to accentuate and speed up this inevitable change by the adoption of a tariff policy, or whether it would be better to make the readjustment as gradual as possible by a continued adherence to the system of Free Trade.

Non-Tariff Protection. These, however, are not in reality the only possible alternatives, although public opinion is very apt to think of them as if no third possibility existed. Public opinion is used to the historical controversy between Tariffists and Free Traders, and finds it difficult to think in any other terms. But in recent years, side by side with the development of tariffs, there has been a considerable growth, as we have seen, of other forms of protection

by the regulation of imports through licensing systems, quotas and other forms of State control. It is worth while considering whether these methods might not offer fewer disadvantages than tariff protection, if they were used as part of a deliberate scheme of adapting the British economic system to the changed structure of the post-war world.

The method of import restriction is already in existence in Great Britain in the case of dye-stuffs, where it was adopted in order to maintain and foster the dye-stuffs industry established during the war. Under this system dye-stuffs can be imported only under a licence granted on the advice of a special committee on which both producers and consumers of dye-stuffs are represented. The consumers can at any time ask that the importation of a particular product shall be allowed, on the ground that adequate supplies of good enough quality cannot be obtained in Great Britain, or that the prices charged by the British producers are too high. The producers are then called upon to show that they can meet the consumer's demand at a reasonable price; and, if they cannot, imports are allowed to come in. It is not suggested that this system works smoothly or without friction; but it is at any rate far more flexible in its application than a tariff, and far more capable of being used as an effective instrument for the stimulation of production and the regulation of prices in Great Britain. It could obviously be extended over a much wider field, in such a way, if it were properly administered, as to give the producer as much protection as might be thought fit and at the same time the consumer a sufficient safeguard against exploitation by the home monopolists.

Import Quotas and Import Boards. An alternative system of import restriction is that of the quota—to be distinguished sharply from the so called " quota " recently adopted for British wheat (for this is in reality not a quota at all, but purely and simply a disguised subsidy to the British wheat grower). Under the quota system properly so called, the State limits the importation of a particular

commodity to the amount which is necessary in order to supplement the home supply, but leaves itself free at any moment to permit additional imports if it appears that home producers are taking advantage of their privileged position to raise prices to beyond a reasonable level. This system again is far more flexible than a tariff, and far more certain in the amount of protection it affords to the home producer.

Thirdly, there is the policy, advocated in Great Britain by the Labour Party, of Import Boards—that is to say, of bodies acting directly under the State through which the entire supply of the commodities concerned needed from abroad would be bought and placed on the wholesale market. It is usually contemplated that these boards should either themselves buy or regulate the sale of the home product, in addition to purchasing the necessary imports ; and their object would presumably be, as in the quota system, to secure an adequate market for the home product, and to limit purchases abroad to the quantities necessary to supplement the home supply. This would, of course, involve a State monopoly of the wholesale trade in the commodities concerned ; and it is doubtful if the system could be applied, at least in the first instance, except to commodities which are highly standardised in type and imported in large bulk into the country. The case for it has been argued mainly in terms of wheat, meat, and certain other foodstuffs, and occasionally of such commodities as semi-manufactured steel and raw wool. The object behind it is largely that of substituting for the general principle of individual small purchases of imports bulk contracts under which Great Britain would agree to purchase the whole or a large part of the exportable surplus of, say, wheat or wool or meat in certain Empire or foreign markets. It is argued that this could be done at a lower price than has now to be paid under conditions of competitive buying, and further that the bulk control of imports of staple commodities would make possible in Great Britain a great reduction in middleman's costs. But an even more powerful argument in favour

of the system of Import Boards is that it might serve as a basis for large reciprocal contracts across international frontiers on a basis of virtual barter. Thus, if Great Britain purchased from Canada or Australia a large part of their available supplies of certain primary foodstuffs and materials, they might agree in return to buy from Great Britain a certain quantity of manufactured steel or other bulk exports, or even to use the sums placed to their credit on account of their sales of raw commodities as a credit in London for the purchase of British goods of any kinds. Brazil and the United States, it has been pointed out, are already exchanging coffee against coal; and there have been large transactions practically in the nature of barter between the Co-operative organisations of Great Britain and Russia. Why not apply this principle of barter over a wider field, primarily perhaps within the countries of the British Empire, but also between, say, Britain and the Argentine and Britain and Russia?

There are thus three alternative forms of protection, besides the crude method of the tariff, that are worthy of consideration if it is decided to adopt a protective policy at all; and in each case these alternatives have the merit of being more flexible than the tariff and far more readily adaptable as part of a coherent policy of economic planning. Thus, if Great Britain is decisively to abandon her traditional policy of Free Trade, there is no need to consider a protective tariff as the only available alternative.

But is the abandonment of Free Trade to be regarded as merely a concession to a temporary emergency or a passing whim of panic-stricken public opinion, or as a final alteration in the economic attitude of Great Britain? In this matter everything depends on the policy pursued by other countries. The further economic nationalism is pushed in the world as a whole, the more difficult it becomes for Great Britain to maintain a Free Trade system. For, while the erection of tariff and other barriers against her exports limits her capacity to sell goods abroad, the narrowing of the Free Trade area in the world also exposes those

countries which retain the Free Trade system to an intensive dumping of foreign products within their borders. This doubtless benefits their consumers as consumers ; for it enables them to buy goods often at less than their real cost of production. But it may also so stimulate imports, while checking exports, as to render the economic position of such countries permanently untenable, and expose their manufacturers to forms of competition against which they cannot be expected to stand up. Thus, if the rest of the world continues to pursue the path of economic nationalism even on the basis of wider unified customs areas than at present exist, there can be little doubt that Great Britain will be driven to maintain some form of protection, either by tariffs or by other means. But if, on the other hand, the world as a whole can be persuaded to revert to a more liberal economic policy, Great Britain has a very strong interest in maintaining her position as a great exporting country ; and she is therefore likely to be ready to take the lead in any such movement. It does not follow that even in this case she will return to complete Free Trade ; but she will be likely to use such instruments as Import Boards less for the purpose of restricting imports than for the promotion of international exchange through large bulk contracts for the direct exchange of goods for goods with overseas countries both in and outside the Empire.

§ 6. ECONOMIC NATIONALISM IN THE UNITED STATES

ON THE continent of Europe there are, as we have seen, overwhelmingly strong economic reasons for the breaking down of tariff walls and the development of larger areas of free economic intercourse. The case against this liberation of European trade, such as it is, rests mainly either on political grounds, or on the vested interests of industries

already established in the separate countries under the system of high protection. There is no doubt, however, about the economic loss in which European separatism involves the people of Europe as a whole.

In the United States, on the other hand, the position is somewhat different ; for the area of the North American continent, even apart from Canada, is large enough, the population great and rich enough, and the economic resources and productive powers sufficiently comprehensive and diverse, to make a possible foundation for a fully developed economic life almost independent either of outside areas of supply or of foreign markets. This is not to say that the American economic system as it stands is independent in this degree, or that the United States can become fully independent either without serious loss or without a drastic reorganisation of her economic life. But self-sufficiency, or a near approach to it, is a just possible ideal for the United States, whereas it is impossible and absurd for any of the separate nations of Europe. There is room within the area of the United States for all the mass production and all the specialisation of plants that are needed in order to get the fullest economies possible on the basis of modern technique ; and there are only a few raw materials which the United States is not capable, if she gives her mind to it, of producing in adequate quantities at least for her present needs within her own territories. In these circumstances it is not surprising that the United States has been, from the middle of the nineteenth century at least, a country of high tariffs, or that she still preserves her tariffs at a high level to-day ; for her own market has been throughout the last three-quarters of a century of her development more important to her than the foreign market, and she has been always conscious of her possession of ample resources awaiting economic development, and therefore of adequate outlets at least until the past few years for all the capital that she has been able to accumulate. Even now, although the United States occupies one of the foremost positions in the absolute magnitude of her foreign trade, imports and

exports are small in relation to the volume of goods produced and consumed at home.

Behind her high tariff wall the United States has developed for the greater part of her population a higher standard of life than exists anywhere else in the world. She has indeed the problem of low-paid negro labourers and cultivators in the South, and of the poor whites who are now being used to man the cotton mills in the Southern States. But, apart from these sections of the population, there was until the coming of the great slump no doubt about her ability to secure for most of her people an exceedingly high standard of life in relation to that which existed anywhere else. This standard was not, indeed, so high as it appeared to be in terms of money ; for the American price level was also higher than those of European countries, largely as a consequence of her policy of high protection. But even when allowance is made for the higher cost of living in the United States the superiority of her standards remains unchallenged. It is true that the American farmer has long lagged far behind his contemporaries in the towns ; but even so his standard is much higher than that of the small cultivators in any European country.

To a large mass of American opinion any tampering with the tariff seems to menace this established high standard of life. It is true that the farming interests would like to buy their manufactured goods at a cheaper rate, and find themselves little protected against movements of world prices of primary foodstuffs and of such raw materials as cotton. But the farming interest has never in recent times been in a position to govern American economic policy ; and there has been no doubt about the protectionist attitude of the business classes which have been chiefly influential at Washington and in the election of Presidents and Congresses. The American worker, too, has been inclined to support high protectionism as a safeguard of his standard of life against the competition of foreign labour and its lower standards ; and accordingly, while there have been periodical movements, headed usually by the farmers, for a

downward revision of tariffs, these have had only a short-lived success, and the general course of tariffs up to the Hawley-Smoot tariff of 1930 has remained definitely upward.

The American Tariff and Europe's Debts. This high tariff policy was easy enough for America to sustain as long as she continued to be in need of more capital for her internal development than she was able to supply out of her own resources. But when her vast loans of capital to Europe and South America during and after the war made her a great creditor nation the position was somewhat different. She had in a number of industries, as well as in the supply of raw materials, a productive capacity well in excess of the needs of her home market. While she remained an importer of capital she was able to meet interest and sinking fund payments on her borrowings out of this excess of products over her domestic needs ; but when she passed into the stage of exporting capital instead of importing it, and of being owed large sums by the rest of the world, she plainly needed, if her accounts were to balance, an excess of imports instead of an excess of exports. This excess of imports could have taken only two forms—either the United States could have lowered her tariff barriers so as to have received in payment a larger quantity of manufactures from her European debtors, or she could have increased her intake of foreign raw materials chiefly from the less developed countries ; and her European debtors could then have made payment by the export of goods to the countries providing these materials. Or, of course, she could have done both these things. The first course, however, was excluded by the strength of protectionist sentiment among the most influential classes of the American public, while the second depended in the last resort on the expansive power of the market in the United States for consumers' goods—for manufacturers would clearly purchase only as much raw material as they needed for the production of finished goods. But, as we have seen in an earlier chapter, the rise

in the American standard of life, and accordingly in the consumers' demand from the general public, was not anything like commensurate with the increase in productive power, or with the magnitude of the change in America's international economic position. Accordingly, the United States continued to export more goods than she imported, and thus to exaggerate the magnitude of the debts owing to her from abroad—debts which, if they were not paid in goods, could be paid only in gold or by an export of capital from the United States which was bound to take the form either of an export of gold or of leaving the balance due from foreign countries for reinvestment overseas.

By means partly of the import of gold and partly of overseas investment of capital, the United States did manage to carry on during the years preceding the world slump ; but her position as a great creditor country with a surplus of visible exports over visible imports remained profoundly unnatural. Her creditor position was to a great extent inconsistent with the idea of economic self-sufficiency which still dominated her fiscal policy ; and it was still more inconsistent with the desire of her producers to keep out foreign imports and at the same time to expand their exports in order to take yet further advantage of the economies of mass production.

America's Choice. Among a small section of informed American opinion the existence of this contradiction in America's economic policy has for some time been realised ; and the result has been a movement among the more progressive sections of American opinion for a downward revision of tariffs. But the obstacles in the way of the success of this movement are enormous ; and the slump, for the present at least, adds vehemence to the demand for higher protection. America is still endeavouring to reconstruct her shattered economic life behind a high tariff wall and on a purely national basis—either disregarding or relegating to a quite inferior degree of attention her economic connexions with the rest of the world. She is still

treating the debt problem, not as something indissolubly bound up with the reorganisation of her economic life, but as a separate issue to be solved or left unsolved without any recognition of its connexion with America's economic problem as a whole. But along these lines the debt problem not only cannot be solved but is bound to prevent the solution of the wider problem of which it is a part. It must, moreover, be admitted that, even if all existing debts due to the United States were absolutely cancelled, the problem of America's economic relationship to the rest of the world would be by no means completely solved ; for there would still remain the problem of her current surplus of exports over imports. A solution of the debt issue would, however, make this other issue far easier to deal with.

It is, of course, fatally easy for those who are not Americans to look at the problem of America's economic position from the standpoint of their own interests and without a sufficient regard for the point of view of the American public. Europe obviously wants to get out of paying its debts to America ; for it can see no possible means by which they can in effect be paid. Europe, of course, wants the American tariff lowered ; for European manufacturers badly need an expanded market for their goods. But assuredly America will neither forego debts nor lower tariffs simply in order to suit Europe's convenience ; and she is least likely of all to do these things while she sees the European countries busily throwing away their own economic opportunities, and making their task far harder than it need be if they would but show a reasonable amount of commonsense. European tariff frontiers seem to Americans far more ridiculous—as indeed they are—than a high tariff wall round the vast area of the United States ; and the vast expenditure on armaments, as well as the economic loss which small-scale nationalism in Europe involves, strikes the American public as a sign of Europe's unfitness to receive generous treatment. In fact, if Europe wants to see the United States adopt a more liberal economic policy the surest way of realising that desire is for the European

countries to begin by setting their own houses in order, so as to be able to talk to the United States, not as a congeries of isolated and often hostile units, but as an economically united area commensurate in wealth, population and freedom of trade with the North American continent.

§7. THEORIES OF FOREIGN TRADE

IN THE foregoing sections of this chapter an attempt has been made to discuss the existing position of world trade and of tariff policy in the various countries with a minimum of theoretical technicality. We have seen that since the war the tendencies towards economic nationalism that existed in pre-war days have grown stronger and extended over a wider field : so that even the countries—above all Great Britain—that have been in the past the strongest adherents of Free Trade have been led to modify their policy and to resort to some form of protection as an answer to dominant protectionism elsewhere. It is now time to consider how far Economics as a would-be science is in a position to shed any light on the advantages and disadvantages of the two rival systems of protection, or economic nationalism, and Free Trade, or competitive internationalism on a capitalist basis.

Any attempt, however, to state the view of the economists brings us at once into a difficulty ; for there is no view common to economists of all schools of thought. Indeed, throughout the history of economic doctrines there has been a sharp cleavage between those who have thought primarily in terms of Economics as a system of exchange—apart from politics and to be kept as free as possible from political Interference, and those who have regarded Economics and Politics as inexplicably bound together. In Great Britain the former of these two schools of thought has so long completely dominated the teaching of Economics in schools and Universities, as well as the economic policy of the country, that British opinion has almost come to regard

Economic Theory as laying down the superior merits of Free Trade as an unquestionable deduction from fundamental laws. Almost every economic text-book in Great Britain from the time of Adam Smith has stated the theory of Free Trade as the international form of the division of labour in modern society, so as to make it follow logically upon the explanation of the division of labour as the basis of economic exchange. Englishmen have been apt not merely to regard this doctrine as axiomatic in relation to their own national affairs, but also to treat it as the fundamental prescription of a universal Economic Theory equally applicable to all times and places. But neither continental nor American economists have ever taken this view, although they have in varying degrees been influenced from time to time by the confident formulation of the English doctrine. Protectionism in Great Britain has always been practically without support among theoretical economists, or at all events has had to be apologised for among them as an enforced deviation from the theoretical correctness of Free Trade. But Americans such as Carey and Germans of the historical school set out to build up an Economic Theory on quite different foundations from Adam Smith, and never accepted his fundamental postulate. German economists in particular have tended far more often to begin with the conception of political or national economy as a branch of statecraft, and to refer all economic thinking to the welfare of the national community as its end rather than to the creation of the maximum sum-total of wealth.

The Doctrine of Laisser-Faire. In order to understand this contrast it is necessary to see clearly on what foundations and assumptions the two rival schools of economists have based their doctrines. For Adam Smith, as for his British successors, the fundamental assumption is that of private enterprise—of a business world consisting of individual *entrepreneurs* endeavouring to produce goods at a profit, and employing the various factors of production

with this object in view. This business system is thought of as existing and working in independence of any action by the State. The State indeed is bound at certain points to interfere with it, and to lay down conditions for the conduct of business enterprise. But the assumption is that this State intervention should be kept down to the minimum, and that it will always tend to decrease the sum-total of wealth created, even when it is justified on other grounds. Thus Adam Smith defended the British Navigation Laws on political grounds, although he held they were bound to reduce the sum total of British wealth ; and in the same way modern British economists have defended Factory Acts, Minimum Wage Laws and other forms of state intervention as necessary to the furtherance of human happiness but have at the same time regarded them as necessary evils as bound to interfere in some degrees with the business of wealth production. The need for a growing amount of intervention has been recognised ; but it has still been held that each act of intervention requires exceptional social justification, because it is bound to run counter to the fundamental postulates of economic individualism.

The underlying conception, then, of British Economics has been that of a business system essentially independent of the State. But there is clearly no reason, if this is the character of the business system, why it should stop short at any national boundary, or take more notice of national frontiers than the interference of the various States with its free working compels it to do. As fast as economic intercourse becomes in fact cosmopolitan, Economic Theory of this sort becomes cosmopolitan too. It thinks of the fundamental economic object as the increase of the world's total wealth irrespective of national frontiers ; and the conception of *entrepreneurs* operating across these frontiers presents for it no essential difference from the conception of purely internal acts of exchange. There is, in orthodox British Economic Theory, really no separate theory of foreign trade or international economic relations. There is indeed a theory of the foreign exchanges ; for the necessity of

changing one national money into another in order to make payments across national frontiers cannot be avoided as long as the currency continues to be on a national basis. But the ideal of British Economic Theory is a world in which the existence of political frontiers, if it continues at all, interferes as little as possible with the world unity of the business system.

The theory of Adam Smith and his successors is therefore essentially cosmopolitan rather than international. They think in terms not of organising the economic relationships between nations, but of transcending national boundaries altogether in economic affairs, or at least of recognising their existence only where national action is bound to impinge upon economic operations on *non-economic* grounds. Any theory which sets out from these postulates is bound to regard Free Trade as the fundamentally right system—as a mere extension corresponding to the growth of the market or the removal of internal *douanes* and similar barriers to trade within a single country. Of course, even within the framework of this theory, a State might under exceptional conditions be justified in adopting a tariff policy; but the justification would have to be fundamentally non-economic.

List's National Economics. In sharp contrast to this cosmopolitan Economic Theory stand those theories of the economic world which set out to consider business affairs from the standpoint of the national State, and regard the regulation of business primarily as a branch of statecraft. Freidrich List has usually been treated as the characteristic exponent of this type of National Economics; but he was in fact very largely influenced in his theories by the Economics of the classical English school. For even List, the exponent of the "national system" of economics, regards Free Trade as the end towards which the policy of a developed economic nation must finally be directed. He wants Germany or the United States to adopt a tariff system in order to foster national industry and commerce,

and thus make the State wealthier and more powerful. But when protectionism has done its work in achieving a rounded development of the national economic system, the tariff barriers are to be flung down and the era of Free Trade is to begin. List held that Great Britain had built up her economic supremacy behind the tariff walls which she knocked down in the first half of the nineteenth century. She had reached already the full economic stature which made Free Trade the most desirable economic system from her point of view. Germany and America would have to pass through a similar evolution by way of protection to complete Free Trade as the final stage of national development.

It will be seen that for List no less than for Adam Smith the fundamental assumption is that industry and commerce will be carried on by means of private enterprise. Free Trade—the free admission of the products of other nations into the domestic market—seems to List the ideal because he is thinking equally with Adam Smith in terms of a business system separate from the political system, though not as uncontrolled by it as Adam Smith wanted the business system to be. List wants political policy—the idea of the health and security of the national State—to govern economic policy ; but he too thinks of Economics as something separate from the political system, and of its aim as the creation of the largest possible sum-total of wealth within the national borders. The difference between him and Adam Smith is that Adam Smith thinks primarily of the world's wealth as a whole, and List of the wealth of a particular nation.

If List's nationalism is accepted as the basis of argument, there is no longer any presupposition that Free Trade must be the right system. List thinks indeed that it will come to be the right system for every country in the end ; but this does not follow as a matter of course from his line of argument. Even if the effect of universal Free Trade must be to secure to the world the largest possible sum-total of wealth, it does not follow that this will be the result for each separate

country. One country may become wealthier by adopting a protective system, even if the effect is to make the world as a whole less wealthy than it would otherwise be. There is therefore, for economists who set out from a national standpoint, no presupposition that either Free Trade or protection is either fundamentally right or wrong. It is a question of expediency, to be settled in accordance with the particular circumstances of each country at each stage of its economic development.

But it is possible to go much further than List did towards a national conception of Economics. For, as we have seen, List continued to regard the maximum production of wealth as the fundamental economic object. But a thorough-going nationalism will by no means agree to this view. For it will regard wealth as only one among a number of things desirable for a nation and will be prepared to subordinate the production of the maximum wealth within a nation to other national ends which it may regard as more important. On this view, which is part of the broad system of Hegelianism, Economics has, strictly speaking, no end of its own. Its function is ministerial—to serve the national welfare, however that welfare may be conceived. Modern Fascism in Italy,.which is closely allied to Hegelianism in its fundamental doctrines, would probably accept this conception of the relationship of the business world to the life of the nation as a whole. On this showing too, there would be no presupposition in favour of either Free Trade or protection. The question would be, as it was in List's mind, purely one of expediency—without List's assumption that all fully developed countries would come in the end to the acceptance of Free Trade.

Socialism, National and International. We have been considering so far two broad schools of economic thought—one national and the other cosmopolitan, one subordinating the business of wealth creation to national ends and the other endeavouring to keep down State interference in business operations to the minimum required

on non-economic grounds, but both alike in thinking of the business world as carried on, with or without State regulation, under a system of competitive private enterprise. The free traders think of private enterprise as a world-wide thing transcending national boundaries. The protectionists think of it rather as shut up within the frontiers of the national political system. But for both private enterprise is the form which economic activity mainly takes. We have therefore to consider other schools of thought which have not set out from this underlying assumption ; for from almost the beginning of the nineteenth century there has been a clash of economic doctrines between Socialists and individualists as well as between cosmopolitans and internationalists. And Socialism, like economic individualism, can assume either a nationalist or a cosmopolitan shape. It was cosmopolitan in Robert Owen, with his vision of a world made up of self-governing village communities based on the principle of co-operation. It was cosmopolitan too in Karl Marx, with his critique of the capitalist system conceived as world-wide in its ramifications, and as destined by its inherent contradictions to provoke world revolution. It was largely nationalist in Lassalle—the true founder of what has been called State Socialism—and in its practical development through the Social Democratic parties of the various countries, despite their theoretical adherence to a Marxism which has been more akin to Lassalle than to Marx. For each Socialist party, compelled to conduct a parliamentary struggle on a national basis and to define its policy mainly in national terms, has come to express its Socialism in demands for the nationalisation of industries, for the better distribution through taxation of the national wealth, and in these latter days in terms of National Economic Planning as well. Socialism of this kind may be internationalist as well as nationalist, in the sense that it desires to promote amity between the nations and much closer co-operation between national units ; but it is essentially not cosmopolitan as Owenism or Marxism on the one side and classical economic theory from Adam Smith

onwards on the other were cosmopolitan in their very essence. That was at the outset the really fundamental cleavage between Communists and Social Democrats. Communism was Marxian cosmopolitanism restated in terms of twentieth century conditions, and aiming at world revolution. There was a fundamental divergence of outlook between it and national Social Democracy, aiming at the parliamentary conquest of the machinery of each national State and at the building up in each country of a national system of Socialism to serve as a basis for international co-operation.

Neither school of Socialists, however, can possibly accept the fundamental postulate of economic individualism on which both cosmopolitans and nationalists among the orthodox schools of economists in Europe and America base their doctrines. And accordingly for all schools of Socialists the controversy between Free Trade and protection is bound to appear largely meaningless, or at any rate a mere surface quarrel. For the national Socialists want to organise the economic life of each State as a branch of the political system; and this clearly implies that exchanges across national frontiers will take place under it, not between individual *entrepreneurs*, but between States themselves, or between organs acting under the direct influence and control of the State. Free Trade implies an absence of State intervention; but a State cannot but intervene in its own affairs. National Socialism therefore implies organised exchange between States as economic units—a policy fundamentally inconsistent with either protection or Free Trade as these are understood by the orthodox schools.

The Russian Attitude. It is something of a paradox that Russia, setting out from cosmopolitan Marxian Socialism, has in fact been led to construct the one large-scale example of national Socialism in the world. This doubtless is none of the Communists' voluntary doing. It has been forced upon them by the failure of the world

revolution to mature according to plan. There is nothing sacred for them about the idea of the U.S.S.R. as a nation, or about its present political frontiers. They would gladly include within it any other areas, even to the whole world, willing to accept the Soviet system, and to become parts of a unified area of economic planning. The Russians have been driven to build up a national Socialism ; but their national Socialism has nothing nationalist about it. In intention it is still as cosmopolitan as Karl Marx, though its leaders are now aware that the road towards a world Socialist order is destined to be much longer and to have in it far more twists and turns than they believed in the first flush of their success in 1917.

Russian policy is thus national in effect but cosmopolitan in idea. But it has nothing in common with the free trade cosmopolitanism of Adam Smith and his successors; for it is based essentially on the idea of a planned economy, and not on *laisser-faire*. The Soviet community, through its appropriate economic organs, will decide where and in what measure the different branches of production are to be carried on, how exchanges are to be organised, at what price goods are to be bought and sold. It will do all these things as matters of deliberate and conscious policy, and without any reliance on an underlying economic harmony such as the classical economists loved to postulate. It will have indeed no tariff frontiers, and it will not need any ; for it will be in a position to govern the movement of goods without them. But its trade, equally with its production, will be socialised and organised, and not left to find its own outlets freely. Cosmopolitan Socialism transcends the entire quarrel between protectionism and Free Trade by aiming at a universal world economic plan.

But national Socialism cannot be quite in this position ; and the Russians, as they are placed to-day, have to organise the exchange of their products with a world which is still for the rest conducted on individualist principles. The Soviet monopoly of foreign trade is a logical and necessary part of the Soviet system of economic planning,

within its own frontiers ; but at these frontiers it meets, not with other States like itself, but with a vast number of private buyers to whom it must sell its goods and of private sellers from whom it must purchase the imports which it needs. It may thus seem as if Soviet Russia in its foreign trading relations is bound to be in much the same position as an ordinary capitalist trader in some other country. But this is in fact very far from being the case. Broadly speaking, exports from capitalist countries can take place only when an individual producer of the goods in question at any rate expects to make a profit by producing those particular goods for export ; and imports are purchased only when those who import them at any rate expect to be able to resell them on profitable terms. With the Soviet the situation is fundamentally different. It needs to buy certain goods from abroad in order to satisfy the requirements of its economic plan ; and in order to purchase these goods it must build up sufficient credits to cover their cost. Save to the extent to which it can finance its purchases temporarily by way of loan, it can get these credits only by the export of its own goods; but the domestic cost of producing these goods for export is almost wholly irrelevant as a factor in determining the price at which they will be sold in the foreign market. They will be sold not for what they cost to produce, plus profit, but whatever they will fetch—which may be more or less than their cost of production, and will be determined by the prevailing level of world prices for similar classes of goods coming from other countries. The amounts of foreign currencies obtained by selling exports for what they will fetch will then be available for purchasing necesary imports ; and these imports will either be used directly as instruments of production in the Soviet factories or mines or on the railways, or will be sold to consumers within the Soviet Union. The prices at which they are sold will bear no necessary relation to their cost to the Soviet Union in foreign money. If the Soviet Union wants to balance its foreign trading accounts so as neither to subsidise its external trade nor to reap a profit from it, it

will merely sell its imports at prices reckoned in terms of the cost of producing in Russia the goods which were exported in order to pay for the imports in question. The whole question of profit or loss on each individual transaction by way of import or export thus comes to be meaningless. The only problem for the Russians is to decide how much they will have to export in order to purchase the imports that they need; and their conception of the quantity of imports they can afford to buy will depend on the quantity of surplus goods which they can spare for export. There is a limit to the extent to which any capitalist manufacturer can afford to "dump" his manufactures in foreign markets; for he must on the whole make a balance of profit if he is to carry on at all. But there is no limit to the ability of Russia to "dump" her products; for, if she sells them cheaply, the only effect is to reduce the quantity and raise the cost to her of the goods she is able to import.

Trade between a Socialist country and a capitalist country is bound to be conducted on these lines—from the standpoint of the Socialist country virtually by the barter of goods for goods on more or less favourable terms. If two Socialist countries, each with a national Socialist system, were trading with each other, the barter element in the transactions between them would become far more obvious and pronounced; and instead of two separate transactions each involving a payment in foreign money, there would be single transaction by way of an exchange of goods for goods even if "money of account" was still used as the basis of the reckoning. If Socialism gets its way in the world one of two things will happen—either all foreign trade will disappear because all political frontiers will disappear and the whole world become a single planned economic system, to which tariffs and free trade will be alike irrelevant; or, if the world comes to be divided up between a number of Socialist communities, these communities are likely to exchange their goods mainly by means of organised barter, so that Free Trade and tariffs will be irrelevant none the less.

CHAPTER IX: PUBLIC FINANCE AND TAXATION

1. The Growth of Public Expenditure
2. The Raising of Revenue
3. Capital and Inheritance

§ 1. THE GROWTH OF PUBLIC EXPENDITURE

AMONG the many influences which have been at work in bringing about the sharp rise in tariffs discussed in the last section has been the growing need of every State in the world for revenue. Tariffs have indeed usually a strong protective object. But from the standpoint of the States which levy them it is by no means a negligible factor that they produce revenue as well; for goods do come in even over the highest tariff barriers, and on very few goods are the tariff rates which are levied actually prohibitive in the fullest sense of the word. Most States, however high their protective duties are, would forfeit a considerable amount of revenue by their abolition; and accordingly there is strong financial as well as industrial pressure to keep them in existence. It does not, however, follow that a State which at present levies very high tariff duties would lose in revenue by lowering them; for the effect of lowering the rates might be to increase considerably the quantities of goods coming into the country over the lower tariff wall. But it is usually very difficult to estimate the probable effect on the volume of importation of any given change in tariff rates; and States which have been in the habit of making their budgets balance by imposing tariff duties at certain levels are usually reluctant for financial reasons

to lower them, and far more inclined to listen favourably to proposals for raising them higher still.

For two reasons, this is especially true of the period since the war. In the first place, the level of public expenditure has risen greatly since 1914. This is due largely to a rise in expenditure on the ordinary work of government and on the social services, but also, and in the countries lately at war very largely, to the heavy increase in the burden of debt. Secondly, during the past two or three years, since the world slump began, States have found increasing difficulty in making their budgets balance on any terms ; for revenue from existing taxes has fallen off on account of the slump, while expenditure includes many items which it is difficult to reduce, and some which rise automatically with the growth of population and as new services inaugurated before the slump come into full operation. Most States are hard put to it nowadays to find the revenue which they need in order to balance their budgets ; and at the same time there is strong pressure from income-tax payers and from industry for a reduction of tax burdens. This drives States to endeavour to raise as much revenue as possible in forms in which the tax-payers will not be fully conscious of bearing the burden ; and this leads to an insistence on the raising of as large as possible a revenue from indirect taxation upon commodities. For, although the consumer has to pay these taxes in the vast majority of cases, the consumer as such is not very well organised and not nearly so articulate as the income-tax payers or the business interests. Moreover, as world prices have been falling sharply, the effect of tariffs in counteracting a part of the fall has been less noticed by the consumers, who have therefore been less inclined to complain seriously of the effect of higher tariffs upon their purchasing power.

All over the world, we have seen, there has been a sharp rise in taxation since pre-war days. In Great Britain national taxation was in the financial year 1928–9 over four times as great in terms of money as in 1913. In Germany national taxation was nearly five times as great as

before the war; but in this case the comparison is somewhat upset by the change in the relations between the *Reich* and the separate German States. In the United States Federal taxation is actually more than five times as great as before the war. In France, on the other hand, national taxation has not much more than doubled. If local as well as national taxation is included in the comparison the position is somewhat different. French taxation has still about doubled; but taxation in the United Kingdom is rather less than three and a half times as great as before the war, and in the United States rather over four times. In all these countries, as we shall see, the increased tax burden is very largely due to the growth of debt, but arises also from substantial development in the social services provided or grant aided by the Central Government, and from some transference of expenditure which was previously made by local bodies to the national exchequer.

The National Income. These figures showing the relative rise of taxation in different countries require to be supplemented by some consideration of the relative changes in taxable capacity. For taxes are best considered in relation to the national income and to its distribution. Not only has a country with a high national income obviously a greater taxable capacity than one with a lower income per head, but taxable capacity tends to rise more than in proportion to the increase in income. For, save to the extent to which essential services are provided *gratis* by the Government or by the local authorities, taxation should obviously fall on the surplus of incomes over necessary expenditure. The distribution as well as the gross amount of the national income therefore very greatly affects the taxable capacity of a country; and this has to be considered in relation to the character of the taxes imposed—for different taxes bear very differently on the different sections of the population and upon the various forms of income.

There are no very reliable estimates of the relationship between national income and public taxation in the leading

PRE-WAR AND POST-WAR REVENUE OF THE LEADING COUNTRIES

	UNITED KINGDOM 1913–14 £ millions	UNITED KINGDOM 1928–9 £ millions	GERMANY 1913–14 millions of marks	GERMANY 1928–9 millions of marks	FRANCE 1913–14 millions of francs	FRANCE 1928–9 millions of francs	UNITED STATES 1913–14 millions of dollars	UNITED STATES 1928–9 millions of dollars
National Revenue	163	685	1,960	9,357	4,134	45,706	661	3,542
State Revenue	—	—	1,140	—	—	—	304	1,507
Local Revenue	94	191	1,378	—	943	7,938	1,155	4,641
TOTAL	257	876	4,478	9,357	5,077	53,644	2,120	9,690
National increase per cent.		321	—	377	—	121	—	436
Total increase per cent.		241	—	—	—	111	—	344

PRE-WAR AND POST-WAR TAXATION AS A PERCENTAGE OF NATIONAL INCOMES

	1913	1924–5	Taxation per head (1913 = 100)
United Kingdom	11½	25	345
Germany	10½	29	—
France	14	20	180
Italy	8½	20	—
Switzerland	7	15	—
United States	6⅔	11	274

NATIONAL INCOMES OF GREAT BRITAIN AND THE UNITED STATES EXCLUDING DEBT INTEREST

	National Income billions of dollars 1914	1924	Income per head dollars. 1914	1924
United Kingdom . .	10.7	17.2	248	384
United States . .	37.1	79.1	375	697

NATIONAL INCOMES OF THE LEADING COUNTRIES, INCLUDING DEBT INTEREST

		National Income billions of dollars	Income per head dollars	% of U.K. per head
United Kingdom . .	(1924)	19.4	435	100
United States . .	(1927)	76.4	652	150
Germany . .	(1928)	15.5	231	53
France	(1927)	8.9	218	50
Italy	(1925)	5.6	140	32
Belgium . . .	(1926)	1.8	223	51

PRE-WAR NATIONAL WEALTH PER HEAD IN THE LEADING COUNTRIES IN £ STERLING

Over £400. United States.
" £300. United Kingdom, France, Argentine, Canada, Australia.
" £200. Germany, Switzerland.
" £150. Holland, Sweden, Denmark, Belgium.
" £100. Spain, Italy, Austria-Hungary.
" £75. Russia, Norway.
" £40. Japan.
Under £30. India.

NATIONAL DEBTS OF THE LEADING COUNTRIES.

		1913–14	1930	Percentage increase
United Kingdom	pounds millions	668	7,596	1,037
United States	dollars ,,	1,028	16,185	1,475
France	francs ,,	34,188	482,179	182*
Germany	marks ,,	4,926	10,375	111†
Italy	lire ,,	15,281	89,876	60*
Japan	yen ,,	2,506	5,959	139

* Allowing for the devaluation of the currency.
† Not including Reparations.

NATIONAL DEBTS PER HEAD OF POPULATION IN 1913-4 AND 1930, IN POUNDS AND DOLLARS AT PAR.

	1913–14 pounds	1930 pounds	1913–14 dollars	1930 dollars
United Kingdom	15	166	73	808
United States	2½	27	12¼	131
France	32	95	157	466
Germany	—	8	—	39
Italy	18	23	88	113

countries, but it is clear that in certain of the countries lately at war public expenditure now absorbs a very high proportion of the total income of the people. In Great Britain, for example, it has been reckoned that in 1913–14 total taxation, both national and local, took about 11½% of the national income, whereas in 1924–25 the proportion had risen according to one estimate to 22% and according to another to as much as 25%. At the present time, in view of the emergency taxes levied in 1931 and 1932 and of the fall of the national income owing to the slump, the proportion is certainly a good deal higher. Germany alone has a higher tax burden than Great Britain in proportion to national income; for, whereas before the war the total weight of the taxes in Germany was estimated at 10½% of the national income, in 1924–5 this had risen to about 29%, and there has been a sharp further rise since then. In France pre-war taxation, national and local, was about 14% of national income as against about 20% in 1924–5; while in the United States the pre-war proportion was under 7% and that of 1924–5 only 11%. The American figure is of course a good deal larger now in consequence of the slump; but the rise is due less to an increase in taxation than to the sharp fall in incomes. Putting these figures in a somewhat different way, we can reach the conclusion that taxation per head rose in the decade between 1914 and 1924 by about 245% in Great Britain, by about 80% in France and by about 174% in the United States; but I have not been able to arrive at any comparative estimate in the case of Germany.

The Causes of Higher Expenditure. A glance at the national accounts of the various countries is enough to show how these great increases in taxation have mainly come about. They are due, as we have seen, partly to the rising costs of government and the increase in the social services, and partly to the great increase in the amount of interest-bearing debts. The national debt of the United Kingdom is now more than eleven times as great as it was before the

war, and that of the United States more than fifteen times as great. On the other hand in France, owing to the devaluation of the franc to one-fifth of its pre-war value, the real amount of the national debt in terms of gold francs is less than three times as great as that of the pre-war debt, while in Germany, where the pre-war mark practically lost its value during the period of inflation, the present national debt is only twice as much as the pre-war debt. This figure, however, takes no account of the claims of the Allies for reparations. Both absolutely and in relation to the national income Great Britain is now carrying by far the heaviest debt burden in the world. It is easiest to make the comparison in terms of a common currency, and to use American dollars for this purpose. At the relative values of national currencies in terms of dollars as they stood in 1930 the national debt of the United Kingdom per head of population was in that year 808 dollars, that of France 466 dollars, that of the United States 131 dollars, that of Italy 113 dollars, and that of Germany, excluding reparations, only 39 dollars. The United States debt was estimated as representing about 8½% of the capital wealth (not income), whereas the national debt of the United Kingdom represented well over one-third of the total capital wealth of the country.

With these considerations in mind let us now try to see how the leading countries spend the money which they raise by way of taxation and to a small extent from other sources, and how they set to work to raise the money needed for this expenditure. It is not easy to make exact comparisons between the leading countries because of the differences in their political structure and in the nature of the services they undertake, as well as because their methods of national accounting are not the same. But in the following table a broad general comparison is made between the four leading countries—the United States, Great Britain, Germany and France. For the purpose of the table expenditure has been divided under three broad heads—debt services, fighting services and police, and civil services including the general expenses of government. It will be seen that of the

four countries Germany spends by far the least on both the fighting forces—largely owing to the limitation of her armaments under the Versailles Treaty—and the national debt, although the figures of the debt service include her expenditure on reparations. Great Britain and the United States spend about the same proportion of their total revenue on civil services and general government ; but the comparison is here affected by the fact that a large part of the American expenditure on social services, such as education, is made out of local revenue. If it were possible to make a table comparing total expenditure, including sums raised locally, the proportion devoted to social services by the United States would appear to be much larger than the British proportion, despite the absence in America of an effective provision for the unemployed. The United States spends the largest proportion of national revenue on armaments and police, whereas France spends the largest proportion on the debt services, mainly owing to her very low expenditure on the social services. Great Britain spends a little less than France on the fighting services and much more on social services ; but in Great Britain as well as France the debt absorbs a considerably larger proportion of the total national revenue than anything else. In France well over half of the total national revenue is spent on the debt and in Great Britain as much as 45 %.

National Expenditure in Great Britain. Let us try to see in rather more detail how these large sums raised in taxation are actually spent in the case of two great countries with very different social and political systems. Great Britain, for the year 1932–3, has an estimated total expenditure of £766,000,000. Of this total over £308,000,000 will be absorbed by the service of the national debt, although the sinking fund on the debt has been halved in consequence of the financial crisis and no provision has been made so far in the estimates for the service of the debt to the United States. The next largest item in the national accounts is a sum of £170,000,000 estimated to be spent

HOW THE LEADING COUNTRIES SPEND THEIR NATIONAL REVENUE.

		1928 Debt Services	Fighting Services and Police	Civil Services and General	Total
United Kingdom	pounds millions	369	122	327	818
United States (Federal only)	dollars millions	1,639	1,551	783	3,973
,, ,, (Federal & State)	dollars millions	1,778	1,721	2,311	5,810
France	milliards of francs	30.2	8.5	13.1	51.8
Germany (Reich only)	millions of marks	1,704	190	7,463*	9,357

* Including refunds to State Governments, 3218 million marks.

Percentage Distribution of the Above

United Kingdom	45	15	40	100
United States (Federal and State)	30½	29½	40	100
France	58¼	16½	25¼	100
Germany	18	2	80	100

BRITISH PUBLIC FINANCE — EXPENDITURE

	Expenditure in 1931–2 £ m.	Estimated Expenditure in 1932–3 £ m.	Expenditure in 1913–14* £ m.
National Debt			
Interest and Management	289.4	276.0	16.9
Sinking Fund	32.6	32.5	7.7
	322.0	308.5	24.6
Pensions and Insurance			
Old Age Pensions	38.2	39.7	9.8
War Pensions	50.4	47.6	—
Widows', etc., Pensions (Exchequer Contribution)	10.0	11.0	—
Health Insurance (ditto)	6.5	6.4	4.0
Unemployment Insurance (ditto)	58.8	65.0	0.6
	163.9	169.7	14.4
Grant Services			
Contributions to Local Revenues	46.2	45.7	7.9
Education	56.8	50.5	16.5
Housing	14.5	15.3	—
Road Fund	7.0	2.8	0.9
Agriculture	5.7	5.0	0.4
Health	0.2	0.2	0.2
Police	12.0	11.2	0.4
Unemployment	3.6	4.2	—
Northern Ireland	9.7	10.2	—
Other	0.9	0.7	0.5
	156.6	145.8	26.8

Defence			
Navy	52.2	51.1	49.1
Army	40.8	37.3	29.0
Air Force	18.4	17.7	—
	111.4	106.1	78.1
Other Services			
Tax Collection	11.9	12.8	4.3
Foreign and Imperial	2.9	2.7	1.5
Empire Marketing and Colonial Development	1.4	1.0	—
Prisons	1.0	1.0	0.9
Scientific Investigation, etc.	1.3	1.2	0.5
Unemployed Training, etc.	0.6	0.4	—
Works, Buildings, etc.	5.6	5.1	2.9
Civil Superannuation	1.9	1.9	0.8
Trade Facilities Act	0.5	1.0	—
Other	11.0	8.8	4.9
	38.0	35.9	15.7
Total Expenditure	791.9	766.0	159.6
Less "Economies"	8.7	Add Irish Services	10.7
	783.2		170.3

*Figures from Report of Committee on National Expenditure, 1931.

directly by the national Exchequer on social services administered under national auspices. Unemployment Insurance accounts for £65,000,000 out of this total, War Pensions for nearly £48,000,000, and Old Age and Widows' Pensions together for nearly £51,000,000. These sums exclude the contributions made by employers and employed to the various insurance schemes, and bring in only the contributions made by the Exchequer. But in order to arrive at the total sums spent by Great Britain on the social services certain other forms of expenditure have to be added ; for a large number of important services are administered in Great Britain by the local authorities with grant aid from the national Exchequer, and the total estimated expenditure out of national funds on these grant-aided services, most of which can be called broadly social services, amounts to nearly £146,000,000. Taking these two broad heads of expenditure together, we find that Great Britain is expecting to spend in the current year about £316,000,000 on social services of one sort and another out of national revenue, or slightly more than she expects to spend on the reduced service of the debt now that the sinking fund has been lowered. If, however, payments on the American debt are actually made during the current year, total expenditure on the debt will still exceed expenditure on the social services.

As against the debt and the social services the burden of armaments looks comparatively light ; for it accounts for only £106,000,000, or not much more than one-third of the expenditure on either of the other groups. But although the sums spent on armaments are now a much smaller proportion of the total national expenditure than they were before the war, £106,000,000 is still a very large sum, and one which can be ill afforded in face of the increase in national obligations and the shortage of resources for necessary schemes of economic development.

Now compare this estimated expenditure for the current year with the actual expenditure of the last year before the outbreak of war. In 1913–14 the national debt cost

£24,600,000 as against £308,500,000 to-day. Social services, nationally administered, cost only £14,000,000 as against nearly £170,000,000, and grant aid to the local authorities under £27,000,000 as against nearly £146,000,000 ; while the cost of armaments has risen from £78,000,000 to £106,000,000. Before the war the total expenditure of Great Britain, excluding the services now transferred to the Irish Free State, was about £167,000,000 as against £766,000,000 to-day.

In order to complete the picture, it is necessary to include the expenditure made out of local rates ; but it is not possible to get satisfactory figures of this for any year later than 1928–9. In 1913–14 the total expenditure of the United Kingdom out of rates was £82,400,000 ; and in 1928–9 it was £190,600,000. Adding this to the figures of national expenditure and making allowance for the exclusion of the Irish Free State, we get a total expenditure in Great Britain and Northern Ireland in 1913–14 of £247,000,000 as against about £956,000,000 at the present time.

Expenditure of the United States. Compare this with the national expenditure of the United States. In 1913 the United States spent out of Federal, State and local revenues combined about $2,920,000,000, whereas in 1928 the total had risen to about $12,610,000,000. As the following table shows a far higher proportion of the total expenditure is made locally than in Great Britain, although owing to the rise of the debt burden Federal expenditure is now a considerably larger proportion of the total than it was before the war. Even to-day, however, local expenditure in the United States is still considerably larger than Federal and State expenditure taken together. This is mainly because a much larger proportion of the cost of the social services, and particularly of education, is met out of local revenues. In the accompanying table American expenditure on the various types of service in 1928 is analysed under the main heads, as far as figures are available. It will be seen that, in striking contrast to Great Britain, America spends on

AMERICAN PUBLIC FINANCE EXPENDITURE IN MILLIONS OF DOLLARS.

	1913 $ m.	1928 $ m.	1930	1913 %	1928 %
Federal	692	3,970	—	23·7	31·5
State	383	1,826	—	13·1	14·5
Local	1,844	6,813	—	63·2	54·0
	2,919	12,609	—	100.	100.

AMERICAN PUBLIC EXPENDITURE IN 1928. MILLIONS OF DOLLARS

	Federal	State	Local	Total
Education	15·2	512·0	1,942·9	2,470·1
Highways	92·7	580·9	1,127·9	1,801·5
General Government	358·0	107·0		
Probation	1,551·4	170·0		
Economic Development	178·1	61·4	2,698·9	5,529·5
Social Welfare	58·8	238·9		
Miscellaneous	2·4	6·9		
Public Utilities	77·3	20·3		
	2,333·9	1,697·5	5,769·7	9,801·1
Debt Redemption	905·9	52·4	403·5	1,361·8
„ Interest	733·1	86·9	640·3	1,460·3
	3,972·9	1,836·8	6,813·5	12,623·2

TAX REVENUE OF THE UNITED KINGDOM AND THE UNITED STATES, 1928–9

In pounds sterling at par				
	National		Local	Total
United Kingdom	685		191	876
	Federal	State	Local	Total
United States	728	310	954	1992

In dollars at par				
	Federal	State	Local	Total
United States	3542	1507	4641	9690
	National		Local	Total
United Kingdom	3336		928	4264

education alone nearly as much as on the debt service, and a far higher proportion of her total national expenditure ; on other social services, however, her expenditure is relatively much smaller than that of Great Britain.

§ 2. THE RAISING OF REVENUE

LET US try to see next how the leading countries raise their revenues, confining the comparison for the moment to national taxation, to the exclusion of local rates and other sources of the incomes of local public bodies. I have set out in a table a broad comparison between the methods of raising revenue of the four leading countries, grouping the various taxes under the widest possible heads in order to simplify the comparison. It has not, however, been possible to make the heads absolutely uniform for the four countries because of vital differences in their tax systems. Thus, whereas all four countries possess some kind of income tax, some taxes on inheritance, and some revenue from customs and excise, France and Germany, unlike Great Britain and the United States, raise a substantial revenue from taxes on sales or business turnover and from taxes on property as distinct from income. I have grouped the property taxes with the taxes on income and inheritance under one head, representing broadly the burden of direct taxation, and the taxes on business turnover with customs and excise as representing indirect taxation. But in the case of France the burden of indirect taxation is further increased by the considerable sums raised by means of registration fees, stamps and similar duties, and I have therefore shown them separately in this case alone.

It will be seen that the United Kingdom raises 51% of her total national taxation by means of taxes on income, and a further 9% by taxes on inheritance, making the total burden of direct taxation 60% of the tax burden as a whole. America raises an even larger proportion of her

total taxes in a direct form—66½% of the total falling upon incomes, including corporation incomes as well as those of individuals. But on the other hand the taxes on inheritance are lighter in the United States than in Great Britain. Indirect taxation, despite the height of the American tariff, accounts, even before the imposition of the new British protective duties, for a rather larger proportion of total tax revenue in Great Britain than in the United States. When we turn from Great Britain and the United States, which have largely similar national tax systems, to France and Germany, we find a somewhat different situation. In France almost half the total revenue, or, including registration and stamps, nearly 64%, is raised by way of indirect taxation, and less than 35% by taxes on incomes and property, including the tax on inheritance. In Germany the comparison cannot be so exactly made because of the existence of a considerable number of smaller taxes which it is difficult to classify ; but if these are grouped, as for the most part they should be, with indirect taxation it will be seen that indirect taxation accounts for substantially more than one half of the total, as against about one-third in the United Kingdom and the United States.

Indirect Taxation. These figures are at first sight somewhat surprising ; for it would naturally be expected that countries with systems of high protection would depend to a considerably greater degree than a Free Trade country, such as Great Britain has been until quite recently, on revenue from taxes on commodities. But it will be seen from the figures that revenue from customs duties actually accounts for a higher proportion of total tax revenue in Great Britain than in any of the other three countries. It is 19% of the total in the United Kingdom, 16% in the United States, 12% in Germany, and under 6% in France. This situation arises because of the large sums raised in Great Britain by customs duties which are not chiefly protective in character, but are accompanied by a corresponding excise on commodities produced at home. Duties

HOW NATIONAL REVENUE IS RAISED BY TAXATION.

	United Kingdom 1931–2 £ millions	United Kingdom 1931–2 % of total tax revenue		United States 1930 $ millions	United States 1930 % of total tax revenue
Taxes on Incomes			*Income Tax*		
Income Tax	287·5	40	(Personal)	1,147	31·6
Surtax	76·7	11	(Corporations)	1,263	34·9
	364·2	51		2,410	66·5
Taxes on Inheritance	65·5	9	Death Tax	65	1·8
Taxes on Goods					
Customs	136·2	19	Customs	585	16
Excise	119·9	17	Excise, etc.	462	15·5
	256·1	36		1,047	31·5
Other Taxes	25·5	4	Other Taxes	3	0·2
	711·3	100		3,525	100

	France 1927 millions of francs	France 1927 % of total tax revenue		Germany 1928–9 millions of marks	Germany 1928–9 % of total tax revenue
Income Tax	9,693	21	Income Tax	2,900	33·4
Securities Tax	3,385	7·5	Corporation Tax	550	6.3
Other Property Taxes	903	2	Other Property Taxes	520	6.0
Inheritance Tax	1,942	4·25	Inheritance Tax	100	1.1
	15,923	34·75		4,070	46.8
Business Turnover Tax	8,605	19	Sales Tax	1,050	12.1
Customs	2,617	5·75	Customs	1,050	12.1
Excise, etc.	11,542	25	Excise, etc.	1,592	18.2
	22,764	49·75		3,692	42·4
Registrations, Stamps, Transfers, &c	6,411	14			
Other Taxes	620	1.5	Other Taxes	940	10.8
TOTAL	45,718	100		8,702	100

on imported petrol, tobacco, spirits and wines accounted in 1932 for a much larger proportion of the total customs revenue of Great Britain than protective duties. For the current year the position will of course be changed by the new duties imposed by the National Government; for these are estimated to yield at least £35,000,000 of additional revenue. But even so they are small in proportion to the yield of existing customs duties. In none of the larger countries can even a system of high protection be made a source of revenue sufficient to permit of any considerable lightening of other tax burdens. The position is somewhat different in the smaller countries, which have a lighter total expenditure and depend considerably more on receipts from taxes on commodities. In Denmark, for example, nearly 39% of the total tax revenue, including local as well as national taxation, comes from customs and excise, and the amount of taxation raised from this source is actually larger than the sum raised by taxes on incomes and capital. I give the figures for Denmark in order to compare the tax system of one of the smaller countries with those of the four leading countries.

In these comparisons it must of course be borne in mind that we are considering only the relative magnitude of the various forms of taxation in the leading countries as fractions of the total sums raised in taxation. It should not be concluded that, because America raises 68% of her total revenue by taxes on incomes and inheritance as against Great Britain's 60%, Germany's 47% and France's 35%, the burden of taxes on income is greater in the United States than in these other countries. On the contrary, it is certainly much lighter because taxation as a whole is much lighter in the United States.

The above comparison has been limited to revenue raised from taxation and has not included the sums received by States from other sources. The figures therefore do not coincide with the total figures of national revenue given elsewhere. For all States have some sources of national income other than taxation. For example, Great Britain, France

HOW THE NATIONAL REVENUE IS RAISED.

DENMARK

1929-30
including local taxation

	millions of crowns	% of total tax revenue
Taxes on income and capital	104	15.5
,, ,, land and property	257.5	38.25
,, ,, inheritance	13	2.0
Customs and excise	260	38.5
Stamps	17	2.5
Miscellaneous	21.5	3.25
TOTAL	673	100

and the United States all stand to receive considerable sums in payment of interest and sinking fund on inter-governmental debts. France and the United Kingdom have been receiving reparations from Germany. Of the four countries, only Germany has no important receipts of this kind. Moreover, all countries own some forms of property which bring in revenue, as well as some which involve loss. Great Britain, for example, receives over £60,000,000 in non-tax revenue ; and of this eleven and a half millions comes from the Post Office after the costs of administering it as a national service have been paid. The United States, on the other hand, prefers to run her Post Office at a loss in order to provide the means of communication at the cheapest possible rate for her citizens. Any increase in the number of industries and services directly owned and administered by Governments may either bring in additional revenue to their national exchequers if these services are operated at a profit and if this profit is passed over into the budget accounts, or may involve an increase in expenditure if, as in the case of the United States Post Office, a publicly administered service is run at a loss. Germany before the war had important public services of this kind, including the railways ; and she has some still. But the German railways have been denationalised under the Dawes Plan, and now make their contribution to the revenues of Germany by way of payments earmarked for reparations to the Allied Countries.

Taxable Capacity. With these considerations in mind, we may now proceed to consider briefly the various forms of national and local taxation and their effects on the position of industry and on the distribution of incomes and consuming power in the community. It is often suggested that there is an absolute limit to the taxable capacity of any given country, because after a certain point it is imposssible to find further taxes which will not either react so unfavourably upon business enterprise as to lower the total yield of taxation, or so burden the necessary expenditure of

the poorer classes as to become intolerable. But it is clearly very difficult to define any such limits ; for it matters not only how much is raised by way of taxation, but also how the sums which are raised are spent by the State. The older economists, such as Adam Smith, were inclined to regard all State expenditure as being inevitably wasteful and unproductive, and to treat the burden of taxation as being simply so much abstracted from the national income available for consumption or the enlargement of productive power. But it is impossible to take this simple view of the tax systems of modern countries ; for to a considerable extent taxation is now used as an instrument for the redistribution of incomes in the interests of the poorer sections of the community or of the efficiency of the community as a whole. Sums spent on education, housing, public health, social insurances, benefits and pensions of one kind and another cannot possibly be regarded, if they are spent with due wisdom, as merely abstracted by taxation from the national income. They simply substitute one way of spending this income for another, and give back to the consumers in direct services the equivalent of the amounts raised by the taxes necessary to finance them. More and more, with the development of the social services, this way of redistributing income by means of national and local taxation is being pursued ; and the entire character of the tax system is being altered by it. The older conceptions of taxable capacity have to be fundamentally revised in the light of these new forms of public spending ; for clearly it is possible for a community to spend far more publicly if its expenditure is useful and productive than if it is not.

The Interest on the Debt. In the second place, a large part of the public expenditure of most countries nowadays consists of payments of interest and sinking fund on the national debt. The sums needed for this purpose are raised by taxation ; but they are then immediately handed back to the owners of the national debt, and again become spendable or investable income in their hands. The position is of

course somewhat different in the case of public debts owed overseas ; for in this case the spendable income is repaid to citizens of another country or to its Government, and becomes an addition to the national income of the recipient nation. But as far as internal debts are concerned the sums raised by taxation are redistributed as fast as they are received.

It has sometimes been argued on this ground that national debts, provided they are internal, are no real burden on a country ; but this is to ignore a vital point. For the individuals who receive back the sums paid in interest and sinking fund on the debt need not be the same as those who pay the taxes made necessary by its existence ; nor need the sums paid in interest be redistributed for the better by this means. Thus, whereas the sums paid out in pensions and insurances go for the most part into the pockets of the poorer members of the community and are available to increase their spending on consumable goods—for the most part on the bare necessaries of life—the interest on the national debt is paid mainly to the richer classes, as far as it goes to individuals, and to the business houses, banks and other corporate bodies which among them hold a large proportion of the debt. Some fraction of the payments to corporate bodies is of course used for charitable, educational and similar purposes—for schools, colleges and other endowed institutions hold large blocks of government debt. But the payments made to individuals, which are very considerable, clearly result for the most part in a redistribution of income through taxation which, instead of equalising incomes, tends to make them more unequal. The presence of a great mass of debt on which interest has to be paid thus largely offsets the effect of the growing tendency towards the equalisation of incomes through the expansion of the social services. In Great Britain, as we have seen, the expenditure on the debt, including the external debt, is still larger than the sum spent out of national revenue on all the social services put together, or, to put the matter in another way, the debt service absorbs in Great

Britain considerably more than the total amount paid in income tax, and not much less than the product of income tax and surtax taken together. By far the greater part of the amount raised by direct taxation is thus promptly redistributed, mainly to the richer classes of the community and to corporate bodies, by way of interest and sinking fund on the debt.

The Relation between Revenue and Expenditure. It is thus impossible to divorce the consideration of the raising of revenue from that of its expenditure. The country which owns and administers a considerable number of public services will have a quite different budget of both revenue and expenditure from one which leaves its essential services in private hands. A country with a large national debt will not have to think in terms of the same relation between national income and taxable capacity as one which has a comparatively light debt burden. And finally a country which spends largely on the social services will have to consider the influence of these forms of expenditure on the national income through consumers' demand, as well as its relation to the total taxable income. For it may be that a withdrawal of spending on the social services might cause such a contraction of consumers' demand as seriously to affect the profitableness of industry, and therefore the sums to be derived from taxes falling mainly on the wealthier classes.

In the past economists have usually favoured the raising of the largest possible proportion of total revenue by means of direct rather than indirect taxation. There are several reasons for this view. In the first place it is generally far easier to measure the incidence of direct than of indirect taxes—easier both for the taxing authority and for those who have to pay them. Direct taxes therefore seem to be more honest and above board than indirect taxes, whose incidence cannot be so nicely apportioned in accordance with considerations of social justice. Secondly, direct taxes are nowadays commonly levied mainly upon incomes, and

to a smaller extent upon inheritance, under a graduated system. Usually income up to a certain level is altogether exempt: so that the poorest classes in the community are not called upon to pay direct taxes either on their incomes or on the exiguous property which they leave behind at death. The principle behind this fixing of exemption limits is of course that direct taxes ought to fall on surplus income above the barest requirements, and that the minimum income needed for subsistence ought not to be touched by taxation. Practically all indirect taxes on commodities, except a few luxury taxes, violate this principle; for they fall on goods which are in some measure indispensable directly or indirectly even to the poorest sections of the community. It has been found impossible to raise large sums from taxation of commodities or of business turnover without levying toll on necessaries; for necessaries account for by far the largest volume of total consumption. Moreover the commodities on which it is usually easiest to levy taxation are those which are most widely consumed. Accordingly, indirect taxation levied upon goods or upon business turnover tends to be highly regressive in its incidence. The rich man's consumption of many commodities is not widely different from the poor man's, or at any rate not different anything like in proportion to the difference of incomes. Indirect taxes therefore tend to fall with exceptional severity on the poor whenever they are used as a means of raising any substantial proportion of the national revenue; and this applies to protective duties as well as to other forms of indirect taxation.

There has been a tendency in recent years in the more advanced countries to steepen the graduation of direct taxes on income in order to provide more money out of the taxable surpluses of the rich. Taxes on inheritance have also grown larger, and come to be more steeply graduated; but nowhere as yet has the taxation of inheritance been pushed to a point at which it interferes seriously with the accumulation of large fortunes in private hands. It may indeed press heavily, as in Great Britain, on certain limited

classes, such as the landowners where they depend chiefly on incomes from their inherited estates. But this is true only of a fraction of the land-owning classes in Great Britain; and the accumulation of large fortunes in business and by successful investment and speculation has so far been interfered with very little by the growth of inheritance taxes. If taxation on inheritance is ever to be used, as Professor Rignano and others have suggested, as an instrument for the socialisation of a large part of the national wealth and for the gradual elimination of large private fortunes, it will have to be levied on a scale altogether different from any that has yet been adopted. Indeed nowadays countries treat the product of such inheritance taxes as they do possess as part of their normal revenue and not as capital; whereas if such taxes were being used as instruments for the socialisation of wealth, the sums produced by them would clearly have to be treated as capital, and not used for the balancing of ordinary expenditure. We shall have to return to this point at a later stage. For the present we can reasonably treat the existing taxes on inheritance as closely analogous to taxes on income—the more so because in the advanced countries it is now a common practice to insure against them and, by providing out of income the premiums necessary for meeting them, to avoid any dissipation of large properties by their means.

Direct and Indirect Taxation. Taxes on incomes and inheritance, taken together, are the chief progressive element in modern tax systems—that is to say, they are the chief forms of taxation which fall largely on the richer classes of the community, and almost the only means by which redistribution of incomes in the interests of the poorer classes is attempted through the tax system. On the other hand, as we have seen, taxes on commodities and on business turnover are largely regressive in their effects. Their chief merit from the standpoint of the tax-gatherer is that they are usually far easier to administer than direct taxes. It is easy to levy a customs duty on goods entering

the country, and usually not very difficult to collect excise duties on commodities manufactured within it. It is a far harder matter for the State to get an exact knowledge of the amount of income which is being received by its individual citizens as a basis for an income tax, or for it to value their property for the purpose of taxing it either annually or when they die.

Taxes on income especially are only levied effectively in countries which have reached a fairly high stage of economic development. Great Britain first experimented with an income tax during the Napoleonic Wars ; but it was so unpopular and so difficult to collect that it was abolished as soon as the wars were over, and not reimposed until 1842. The Federal income tax in the United States dates only from the Amendment to the United States Constitution carried in 1913 ; and the French income tax is also new, having been imposed only in 1916 in consequence of the fresh burdens of expenditure due to the war. Even now, the efficiency of the collection of income tax is certainly much less in France and in the United States than in Great Britain ; for it takes a long time to perfect the machinery required for a tax of this sort, and there is still among American and still more among French taxpayers a strong resistance to the necessary inquisition into private incomes. The income tax in France is undoubtedly evaded to a very large extent ; and even in the United States, despite a more drastic compulsion to disclose resources and a greater publicity than exists in Great Britain, the instrument of tax-gathering is still far from perfect. The British tax payer may grumble at the height of the income tax ; but he pays it, and the amount of evasion is believed to be extraordinarily small. The French tax payer also grumbles ; but to a considerable extent he still evades payment.

The Effects of Taxation on Industry. There has been much debate about the effects of taxation on incomes upon business activity. In Great Britain, for example, the Federation of British Industries and other bodies representing

BRITISH PUBLIC FINANCE—REVENUE

	Receipts in 1931–2 £ m.	Estimated Receipts for 1932–3 £ m.	Receipts in 1913–14 £ m.
Inland Revenue :			
Income Tax	287.4	260.0	43.9
Surtax	76.7	66.0	3.3
Estate Duties	65.0	76.0	27.4
Stamp Duties	17.1	23.0	10.0
Other	3.4	2.0	3.4
	449.6	427.0	88.0
Customs and Excise :			
Customs	136.2	174.6	35.5
Excise	119.9	125.4	39.5
	256.1	300.0	75.0
Other Tax Revenues :			
Motor Vehicles Duties (Exchequer Share)	5.0	5.0	—
Total Tax Revenue	710.7	732.0	163.0
Other Revenue :			
Post Office surplus	11.5	11.7	6.2
Other revenue	49.0	23.1	4.4
Total Ordinary Revenue	771.2	766.8	173.6
Self-balancing items :			
Post Office	58.0	59.2	24.6
Road Fund	22.5	22.9	—
TOTAL REVENUE	851.7	848.9	198.2

manufacturing and trading interests have kept up a steady stream of complaint at the high level of the taxes on income, which, they say, are doing much to paralyse industry. On the other hand, the Colwyn Committee on National Debt and Taxation, which reported in 1927, took a different view, and insisted that even a high income tax need have no substantial adverse effect on business and employment. The point at issue is not very easy to resolve. On the side of the Colwyn Committee it is contended that the income tax is levied only upon profits which have been realised and for the most part actually distributed as incomes to individual recipients. The income tax therefore, it is urged, cannot effect the incentive to the business to produce goods, since it does not reduce the volume of the expected profit. A firm which makes profits does not have to pay taxes on them ; for the income tax falls to be paid by the individual shareholders on the sums which they receive as dividends, and they do not have to pay if their total incomes are below the exemption limit.

This indeed need not apply to that part of the profits which is left in the business for accumulation as a reserve instead of being distributed in dividends ; for in Great Britain such reserves are taxed at the standard rate. Business men usually contend that the taxation of undistributed profits checks the accumulation of capital, and is therefore bad for business enterprise. But it has to be pointed out that reserves are taxed only at the standard rate and that, in as far as the shares in a business are owned by persons whose total incomes are large, less is paid in tax in this way than would be paid if the total profits were distributed. For the shares go up in capital value as a result of the accumulation of reserves ; but the individual owner does not have to pay income tax on this form of capital increment. The present system of taxing reserves only at the standard rate is therefore favourable to rich as against poor shareholders—for all alike have to pay on the reserves at the standard rate of taxation, whereas if the sums in question had been distributed as incomes some of them would

have paid at more than the standard rate and some at less, while yet others would not have had to pay at all. It is however true that, if business reserves were not taxed at all, a strong inducement would be given to business men to distribute less of their profits in dividends and to accumulate more in the business as reserves. This would certainly encourage capital development, but it would achieve this result largely at the expense of the poorer shareholders; for the amount of taxation which the rich would escape by this means would be very much larger than the relief afforded to the poor.

Obsolescence. In support of the claim for reduced taxation or no taxation at all upon reserves accumulated in the business, industrialists argue that nowadays it is necessary to make much larger provision than used to be the case for wear and tear and obsolescence of plant and machinery. Business technique changes more rapidly; and often plant has to be scrapped in the interests of efficiency long before it is physically worn out. This is undoubtedly true; but the correct remedy seems to lie rather in increasing the allowances for depreciation of plant and machinery now made under the income tax laws of the different countries than in giving complete exemption from taxation to accumulated reserves. For there is no obligation upon a firm which escapes taxation of its reserves to make proper provision for new plant, and no necessary correspondence between the proper provision for obsolescence and the amount of profits reserved in the business.

Does High Taxation Restrict Enterprise? The Colwyn Committee, as we saw, regarded the income tax as falling mainly upon profits after they had been assigned to the individual shareholder as income, and therefore as not affecting the margin of profit which a business could be expecting to make. Being levied upon profits, the income tax was not, in the opinion of the Colwyn Committee, to be regarded as an addition to the costs of production, and it

was on this ground that the Committee held that a high rate of income tax would not necessarily act as a discouragement to production. But this view is not universally accepted ; and when the Committee's Report appeared a number of economists at once took objection to it. For, as they pointed out, the inducement to embark upon production consists not in the gross but in the net expectation of the profit to be derived from it ; and this depends on the net income which the individual shareholder or investor expects to receive as a result of his investment. Any tax deducted from his income clearly reduces his net expectation of profit in this sense, and therefore discourages him from investing his money in such a way as to subject it to taxation. The critics of the Colwyn Committee held on this ground that a high rate of income tax, while it would not affect the costs of production, would nevertheless serve to discourage the investment of new capital in business enterprise, and would react upon the volume of production in this way. It would not cause the owners of existing productive resources to abstain from their use in production ; but it might prevent the subscription of additional capital for the improving of existing businesses or the setting up of new businesses. In fact, whereas the Colwyn Committee looked at the problem from the angle of capital already invested in business enterprise, the Committee's critics regarded it from the different angle of its effect on saving and new investment.

From their distinct angles of vision both these views are undoubtedly right. As far as existing capital is concerned the raising of the rates of income tax is not likely to affect the will of their owners to use their resources in production ; but the investor, in deciding whether or not to invest in productive enterprise, is guided by his net expectation of profit, and will therefore to some extent be deterred by higher taxation of profits. It is of course true that the income tax will be levied upon his income in whatever form it comes to him. For even if, instead of investing his money in productive business, he lends it to the State he will remain

subject to taxation on the interest which he receives ; but the danger in times of business depression is that the owner of capital will refuse either to invest it or lend it at all, and will simply leave it lying on deposit in the bank in the hope of a return of more favourable opportunities for investment. High taxation levied on incomes can undoubtedly encourage the investor to behave in this way ; but it is doubtful whether it is a major factor, for the investor is far more likely to be discouraged from investing his money in profit-seeking enterprise by the fear that he will not make a profit at all, but rather incur a loss, than by the knowledge that he will be taxed, even highly, on such profits as he does make. The point of view put forward by the critics of the Colwyn Committee is therefore theoretically sound ; but it is doubtful whether, in the present economic situation, it is of much practical importance. For far stronger deterrents than the income tax to investment for profit exist in times of severe business depression such as these.

Local Taxation. National revenue is raised mainly by taxation either on incomes or on commodities or business turnover. But all countries have to face the problem of providing their local authorities with some form of revenue separate from that which accrues to the national State ; and this is usually done by allowing the local authorities to levy certain kinds of taxes distinct from those which are levied on the nation as a whole. It is, however, a very difficult matter to find a satisfactory source of revenue which national Governments are prepared to leave in the hands of the local authorities. In most countries local taxation takes principally the form of rates levied upon property lying within the area of each separate local authority. In Great Britain, for example, the local authorities derive by far the greater proportion of their revenue, apart from what they receive by way of grant aid from the national State, from rates levied locally upon the occupiers of land and house property, or business premises. In some countries local bodies also derive an important part of their receipts from

taxes upon land values, especially the values of urban sites ; and in a few cases they are also empowered to levy a local income tax supplementary to the national income tax levied by the State. But, in general, rates upon property are the chief source from which local revenues are derived.

Whatever doubt there may be about the effects of taxation of incomes on the costs of production and the willingness of business men to undertake productive operations, there can be no doubt about the effect of local rates as far as they fall upon productive enterprise. The cost of such rates has to be borne by the business itself, and to be paid whether or not the business is making a profit. It is therefore definitely a part of the cost of producing goods ; and any increase in the burden of local rates directly raises the costs of production. For this reason, business men have always been strongly hostile to the local rating system, and have often sought to combine in order both to bring pressure upon the local authorities to keep rates down to the lowest possible point and to get a larger part of the cost of maintaining local services transferred from the local rates to the national exchequer. Moreover, when a business man is considering the establishment of a new factory, he is often guided in his choice of locality by the variations in the local rates in force in different areas. He prefers to set up his factory, other things being equal, in an area where rates are low ; and this has been an important factor in causing certain types of business to be transferred from the congested urban areas to country districts well served with through transport facilities.

The Migration of Industries. But for a variety of reasons many businesses are compelled to remain in the large towns. Some must be so closely in touch with a local market as to be unable to risk the remoteness of a country location. In others the individual business is only one in a chain of closely related businesses co-operating in the production of a single type of final product ; and the single business cannot move unless the others move too. In yet

other cases—and perhaps this is the most important factor of all—the business man needs to have near at hand and ready at call a varying supply of skilled labour, in order to meet fluctuations of business activity ; and this he can find only in a town in which the same type of business is carried on by a number of different firms. An enterprise which moves out of the town into the country districts has often, moreover, to incur considerable costs, which may more than offset the saving in local rates. It may have to undertake in addition to the building of the factory the erection of houses and the provision of amenities for its employees, the making of roads and perhaps railway sidings, and even the provision of such public utility services as the supply of water, gas or electricity for the new industrial communities. These are often powerful deterrents ; and they largely explain why the movement of industry from the towns into the country districts has not been more rapid and pronounced than it has been in fact.

In spite of these difficulties there has been a considerable movement both in Great Britain and in the United States ; and there can be no doubt that this is on the whole a desirable thing. For towns are too large and too crowded ; and it is possible to secure better sites and planning of factories and better amenities in less crowded areas. But, whereas new industries tend to grow up largely in the less crowded districts, the older industries for the most part find themselves unable to move ; and especially in times of depression this produces a very serious situation in the older industrial areas. For the depression of the past few years has fallen, as we have seen, with exceptional severity on the older basic industries and on the textile trades, which are the least able to make a move ; and this has meant that in the older industrial towns the decreased ability to meet the charge of local rates owing to the fall in profits has coincided with a heavy rise in local expenditure on account of the depression, especially where any considerable part of the burden of unemployment falls to be met out of local funds.

The Costs of Unemployment. In Great Britain indeed the existence of a general system of unemployment insurance has greatly reduced the burden falling directly upon the local authorities as a result of unemployment ; but even in Great Britain the unemployment insurance scheme does not cover by any means the whole body of unemployed, or provide for them all even the barest maintenance. There are some workers who, for one reason or another, are not entitled to benefit ; and there are others whose benefits have to be supplemented by the Poor Law authorities out of local funds. Moreover, if any step is taken to provide work for the unemployed by public action, at least some part of the cost of this provision has usually to be met by the local authority. The State usually bears some fraction of the cost of work of this type ; but it hardly ever undertakes to meet the whole cost. The older industrial towns have thus the largest amount of unemployment, and at the same time the least resources for dealing with it either by the provision of work or by paying out sums by way of relief. In the United States, where there is no system of unemployment insurance, the burden upon the local authorities is far more serious still, and falls with even greater severity on the districts in which the depression is most serious. Towns such as Chicago and New York have found themselves virtually bankrupt in consequence of the pressing need for spending money in order to give the unemployed even the very barest necessaries of life, in face of the rapid exhaustion of the resources available to private charity.

Local Rates in Great Britain. In Great Britain the pressure of manufacturers, especially in the depressed industries, to secure relief from the burden of local rates led in 1928 to the passing of a new Local Government Act, under which industrial undertakings were largely, and agricultural undertakings completely, exempted from the burden. Under these new conditions industrial properties escaped three-quarters of the rates which they would be called upon to pay according to the valuation of their properties, this

deficit in local revenues being met by an increased grant from the State out of the proceeds of national taxation. By this Act a substantial present was made by the national exchequer to all productive undertakings throughout the country, whether they were depressed or not—for the relief was not confined to the depressed industries, but was given equally to prosperous undertakings able to make a substantial rate of profit. A far larger proportion, therefore, of the total sum raised by local rates now falls upon householders in each locality. It is true that up to the present this has not increased the householders' burden because of the additional grants made out of national funds ; but it does mean that any local authority which desires to undertake additional services will have to place the greater part of their cost upon the local householders.

This is a serious matter ; for local rates, as far as they are levied upon householders and tradesmen and not upon productive undertakings, are undoubtedly largely regressive in their incidence, and fail to correspond at all to differences in ability to pay. The new system means that new local services developed in the interests of the poorer inhabitants will have to be paid for much more largely by the poorer inhabitants than would have been the case under the previous conditions. There were undoubtedly strong arguments in favour of giving some relief to the depressed industries in respect of rate charges ; but the method adopted in doing this was, I think, altogether vicious. For it cannot be denied that industrial undertakings receive considerable benefits from the services provided by the local authorities in whose areas they lie, or that a large part of the expense falling upon the local authorities is due to the presence of these undertakings in their areas. Local rates upon industrial undertakings doubtless fall upon and increase the costs of production. But this is not necessarily a condemnation of them ; for the real cost of producing goods includes the cost of all the services which are necessary to their production, and it is therefore legitimate to charge the productive undertakings with a fair proportion of

the costs of local government in the areas in which they are situated. If it was desired to give relief to the depressed industries, this should have been done, not by relieving all productive undertakings of a large part of their rate burdens, but by the granting of special relief to those industries which were suffering from exceptional depression.

Taxing the Householder. Nor should it be forgotten that, even if rates upon industrial undertakings are unfair in their incidence, so are the rates levied upon local householders and traders. A merchant or a professional man may conduct a business which brings him in a large net income from an office suite occupying only a few rooms and therefore rated only at a low figure, whereas a tradesman usually requires to pay a rent high in proportion to his net takings, and is therefore very highly rated in proportion to his income. Again, the workman spends a much higher proportion of his total income upon rent than those higher up in the social scale ; and rates usually fall upon him much more heavily than upon the middle or upper classes.

The fact is that rates upon local property in any forms in which they have been levied hitherto are thoroughly unfair in their incidence and a thoroughly bad tax. They came into being away back in the Middle Ages when physical property was almost the only thing that could be easily taxed, and when it seemed fair to charge local property with the burden of maintaining the poor. As the functions of local government authorities grew, more and more charges were gradually placed upon the local rates ; and no attempt was ever made to find an alternative form of local taxation that would be fairer in its incidence. Indeed, although almost everyone now recognises that local rates are a bad tax, it is exceedingly difficult to find any substitute for them ; for there is no other form of taxation which the national State is prepared to forego. One suggestion that has very often been put forward is that, side by side with the national income tax, local authorities should be permitted to levy a local income tax of their own. This is already the

practice in certain countries ; but the proposal would be very difficult to carry out in a small and densely populated country like Great Britain. For clearly an individual who occupied premises, or a business enterprise which had factories, in several areas could not be charged in each of these areas upon his or its entire takings ; and the problem of delimiting the amount of income arising in each locality would be very difficult indeed.

A Local Income Tax? Accordingly, the alternative suggestion is often made that local burdens should be met to a much greater extent out of funds levied nationally instead of locally, and that to the national income tax should be added a further so much in the pound specially earmarked for redistribution among the local authorities. This system is in operation to a small extent in France in the so-called *centimes additionels* ; while in Germany the States which make up the *Reich* receive a considerable part of their revenue in the form of a share in the product of the national taxes which has to be returned to them under the new constitution of the *Reich*. Something of this sort seems indeed to be the only solution of the problem of local finance in Great Britain. There has been in progress for some time past a gradual increase in the proportion of total local expenditure borne out of national funds ; and it is clearly desirable at the earliest possible opportunity further to relieve local rates by providing for increased grants from the national exchequer and for the expansion of these grants as local services are further developed.

It is not, however, desirable that the whole cost of local services should be borne out of national funds, or out of sums distributed by the national authority to the local bodies in accordance with a fixed scheme of allocation. For it is necessary in the interests of both local freedom and local efficiency that some part of the cost of local services should fall directly upon the local electorate. Local authorities ought to be able at their own charge to provide services beyond the minimum laid down by the national Government ;

and they ought to have some incentive to spend the money at their command economically. Unless therefore some alternative source of local revenue to the rates can be provided, their absolute abolition seems to be out of the question, although their burden can be considerably reduced by increased appropriations from the product of national taxes.

The one other form of revenue which it does seem possible to assign wholly to local bodies is the taxation of local site values. This already provides a substantial part of the revenue of the larger German towns ; and there seems every reason why, when an effective system of taxation of land values is established in Great Britain, it should be assigned to the local authorities rather than to the national exchequer. There are, however, strong grounds for urging that the areas over which taxes on site values should be levied ought to be larger than those of the existing local authorities. The fairest system of taxation of land values would be one under which they would be levied upon a regional rather than a local basis, and their product assigned to regional authorities rather than to the existing separate local governments of towns and rural districts. But to consider this large question of the reorganisation of local government areas would take us much too far afield from the purpose of this chapter.

§ 3. CAPITAL AND INHERITANCE

LET US now attempt to bring together the various questions so far discussed in this chapter to a considered conclusion. We saw at the outset that it is impossible to lay down any definite limits to the taxable capacity of a nation without taking into account not only the proportion which taxes bear to the national income but also the ways in which tax revenue is spent ; for the more productively tax revenue is employed the larger is the amount of taxation

which any particular nation can afford. Taxation always results in effect in a transference of purchasing power. It takes from the incomes of the individuals and corporations which are subject to taxation sums which it then places at the disposal for spending of the national or local bodies to which the proceeds of taxation are allotted. Just as the individual who receives an income can spend this income wisely or unwisely, so can the public body which appropriates a part of this income by means of taxation. Just as the individual can spend more and save less, or save more and spend less, so can the public body, according as it applies the proceeds of taxation to meeting current needs or to building up productive capacity for the future. But the relation between saving and spending is not quite the same —or at least is not obviously the same—in the case of the individual and the community. We generally regard an individual as spending those sums which he uses in order to buy consumable goods or services, and as saving those which he applies to investment or lending in one form or another, or puts away in the bank. But even in the case of the individual this is not always a fair way of regarding his use of his income. If, for example, a father spends money on giving his children a good education designed to fit them for useful productive activity, he is really saving just as much as if he put his money into some form of business investment. This consideration applies on an even larger scale to the expenditure of the State. For the State can reasonably be regarded as saving rather than spending whenever it is using resources raised by taxation for the purpose of improving the health or the education of the community, and thereby increasing its future productive power. Of course it is possible for a State, just as it is possible for an individual, to spend unwisely on education or on health ; but if the money spent on these services is used with reasonable prudence it is to be regarded rather as saving than as spending in the narrower sense. It is therefore mistaken to regard the recent rapid growth in State expenditure on the social services as being unproductive, or as subtracting

so much from the sums available in the hands of the community for productive use. For it may well be that the sums spent by the State on education, housing and sanitary services are doing more to increase the future productive capacity of the nation than these same sums would do if they were left in the hands of those who originally received them as incomes.

In fact, when the question of imposing an additional tax for the purpose of financing increased State expenditure is under consideration, the real question to be considered is fundamentally whether the money is likely to be better spent by the State or by the individuals from whom it is to be raised. The answer to this question will depend in the first place on the use to which the State proposes to put the money, and in the second place on the sources from which it is to be raised. For there is a very strong case against levying taxes which will fall upon those members of the community whose existing incomes are barely sufficient to meet the minimum needs of civilised life. Taxation must as far as possible be levied upon surplus income—that is to say, upon income which is not needed in order to meet the necessities of life. But even such taxation is only justified if it can be shown that it is likely to be used more advantageously by the State than by the persons who will be called upon to pay.

The Flow of Investments. This raises in the present state of the world economic system certain very difficult questions ; for the present economic system depends everywhere for its successful continuance on the maintenance of a sufficient flow of new investment in profit-seeking business. This investment is mainly made in all developed countries out of the surplus incomes of the richer classes. If, in accordance with the principle of progressive taxation, a steadily increasing part of these incomes is appropriated by the State through taxation the effect will be two-fold. In the first place, as we have seen, the net expectation of profit from investments will be reduced ; and in the second place the net amount of income at the disposal of the rich

for investment will be reduced as well. There is likely then, where the State levies high taxes at a severely progressive rate, to be a substantial falling off in the savings of the rich, and therefore in the amount of fresh capital applied by them to investment in productive enterprise. But this falling off, under the existing economic system, is likely to have serious adverse effects upon the productive capacity of industry. It is true that the State, by the use which it makes of the money, may be raising the productive capacity of the community through the improving of health and educational standards ; but this increased productive capacity will not be translated into actual production unless there is a sufficient amount of new capital being applied to industry to induce employers to provide jobs. Their willingness to provide employment will be indeed increased by the rise in productivity of the individual worker as he becomes healthier and more intelligent ; and this may be sufficient to offset the factors working on the other side. But it is probable that, if the State makes its system of taxation highly progressive at the expense of the larger incomes, the fall in capital investment will react in spite of improving productivity on the willingness of the investing classes to provide employment.

This is still more likely to be the case if a considerable part of the sum raised by the State in taxation is applied not to productive uses, such as the improving of health and education, but to uses which have no productive value, such as expenditure on armaments or on the service of a huge national debt. It is true that the sums raised for the payment of interest and sinking fund on the debt will be again distributed to the holders of the debt, whereas money spent on armaments is wasted absolutely. But the question then arises whether the debt holders will put the incomes which they receive from the State to better or worse use than the original recipients of the incomes upon which the State levied the taxes made necessary by the burden of debt. In as far as the existence of a large mass of debt creates an idle *rentier* class living upon unearned income which it spends

rather than invests, it represents a serious drain upon the resources of the community. I do not suggest that by any means the whole or even the major part of the sum paid in interest on the debt is actually frittered away on such a class; but there can be no doubt that the class of idle *rentiers* has considerably increased of late years as a result of the large fortunes which even the veriest numbskulls could hardly avoid making if luck favoured them during the war.

Socialism and Taxation. To the extent to which high taxation by the State does dry up private investment in industry, it clearly becomes necessary for the State, if it desires to maintain a rate of taxation which produces this result, to step into the shoes of the private investor and itself provide the money needed for economic development. It must in effect apply a part of the sum raised in taxation, not to current spending even of the most productive sort, but to collective investment in industries and services which will provide employment and increase the national production of goods. Many people have envisaged a gradual transition by this method from a capitalist to a Socialist economic system. They have seen the State taking over gradually from the private investor the function of providing new capital for industry, just as it has already taken over from the individual a large part of the cost of providing education and other indispensable social services. Such a transition is indeed theoretically quite possible; but there are very great practical difficulties in its way. For it is not easy for the State to raise by way of taxation sufficient sums for it to become an important provider of industrial capital, without at the same time so drying up the sources of private investment by the fear of heavier taxation in the future as to make the capitalist system unworkable before the Socialist alternative has been sufficiently installed to take its place. It seems clear that, if Socialists do intend to use the State as the instrument for a transition of this sort, they will have to find other forms of taxation than

those now in being, and to provide for a much speedier transition from a capitalist to a Socialist economy than they have usually envisaged hitherto.

The Taxation of Inheritance. This additional kind of taxation can clearly be found only in a vast development of taxation upon inheritance. The existing death duties, as we have seen, are not in any country nearly large enough to have any material effect on the accumulation or transmission of large fortunes. But there is no reason why the taxation of inheritance should not be pushed to very much greater lengths without any such adverse effects on business enterprise as would be produced by, say, a large rise in the rate of income tax. If, for example, either the Rignano scheme or some modification of it were introduced, and the proceeds of the taxation of inheritance were applied by the State definitely as capital and not as income for meeting current expenditure, the ownership of the greater part of the productive resources of the community could be transferred within a measurable period from private to public hands. Many proposals have been put forward with this object in view ; and I have no space here to discuss the various suggestions in detail. Let me select one possible scheme merely by way of example. Suppose the State decided that the entire property of an individual above a fairly small fixed amount should pass to the State at death, but be subject for one lifetime to an annuity representing say 50% of the value of the estate. The rich man making a will would then have no absolute property to leave ; but he would be free to provide for his children by means of the proposed annuity. The State would get the property ; and when his children or his heirs died the charge levied upon it for their lifetimes would lapse and it would become public property unburdened by any charge for interest. The power to leave an annuity would give sufficient incentive to the rich man to accumulate wealth in his lifetime ; for the amount of the annuity he could leave would depend on the total value of his estate at death. By this

method socialisation of the greater part of the wealth of the community could be accomplished very rapidly indeed. Alternatively it would of course be possible to adopt much less drastic forms of inheritance taxation following much the same lines. Only half the estate might be taken by the State at the death of the owner ; or the annuity which he would be entitled to leave might be reckoned on the whole value of the estate instead of only half. There are endless possible variants ; but it is only necessary here to make the principle plain.

Taxation in Russia. If a transition to Socialism is to be made by gradual methods, it seems evident that some drastic form of taxation on inheritance must be the principal financial instrument of the change. Where the transition is made not gradually but suddenly, as it was made in Russia, the State has of course at once to assume the task of providing the fresh capital needed for economic development. It is true that the Soviet Union continues to borrow small sums from its citizens by way of internal loans ; but by far the greater part of the capital needed in Russia is provided directly by the State out of the earnings of the industrial undertakings which have passed into public ownership. This means in fact, as we shall see when we are considering the economic system of Russia in more detail, that the Soviet Union, being in full control, through its ownership of the means of production, of the distribution of the social income, allows only that part of it which is intended for spending upon consumable goods and services to reach the hands of the individual citizens. The capital needed for economic development is abstracted from the current yield of industry before personal incomes are distributed at all. In capitalist countries on the other hand, apart from the sums accumulated as reserves by private business, the whole current yield of industry is distributed to stock-holders in the form of personal incomes ; and reliance is then placed on their willingness to save and invest a sufficient proportion of their incomes to provide the necessary amount of new

capital. The main difficulty in a gradual transition from a capitalist to a Socialist system is to maintain this willingness at a sufficiently high level in face of increasing taxation until the institutions of Socialism are developed enough to take the place of the private investor.

Taxation in the Present Crisis. It remains to consider the more immediate problem with which States are confronted in deciding upon their policy of taxation and expenditure in face of the present economic crisis. Almost every country in the world has been confronted during the past two or three years with an unbalanced budget—the consequence of a shrinkage in revenue without a corresponding decrease in the cost of maintaining the existing services of government. The rapid fall in prices and the decrease in industrial prosperity have combined to cause a very great shrinkage in the yield of taxation ; but, on the other side of the account, while there has been some fall in the cost of maintaining the existing services, there are many fixed items whose real burden has increased very greatly with the fall in prices. By far the most important of these fixed items is the cost of the national debt ; for the fall in prices means that those who are entitled to claim a fixed sum of money as interest on their holdings of the debt are receiving in fact a much larger amount of purchasing power than before. Something has been done to reduce this huge burden by means of voluntary conversion schemes, under which blocks of debt have been re-funded at lower rates of interest. Something has also been saved by the lower rates of interest at which it has been possible to re-borrow at short term the sums required for the floating debt. But these various economies have produced little result in lightening the total debt burden, which has, on the contrary, become very much heavier in its real incidence. Faced with this fixed burden of debt, States are strongly tempted, when their budgets fail to balance, to attempt large retrenchments at the expense of the social services. They have done a little by way of reducing the cost of

armaments; but in most cases no more than enough to offset the fall in prices, so that in this case there has been usually little or no real reduction. The main burden of balancing the budget, where it has been balanced at all, has therefore tended to fall on the social services. Salaries of teachers and other public employees have been heavily reduced; and there has been a drastic cutting down of educational, housing, health and other vital services. The sums paid in benefit or relief to the unemployed have also been drastically scaled down; and new tests, such as the "means test" in Great Britain, have been applied in order to reduce the number of workers entitled to claim relief. In addition, those States which were endeavouring to do something for the provision of employment by means of public works, as well as for the mere relief of the unemployed, have tended to retrench very heavily at the expense of this provision—for it is usually, from the standpoint of immediate direct cost, a good deal cheaper to maintain a man in idleness than to set him to work, though the latter policy may be really much more economical in the long run.

The Disaster of "Economy." This policy of public retrenchment has had disastrous consequences in reducing both the volume of employment and the amount of consuming power in the hands of the community, at a time when the greatest need was to increase consuming power in order to bring into use a larger proportion of the abundant productive resources at the disposal of the world. It would have been far better if States, instead of retrenching at the expense of the social services and of the provision of employment, had taken advantage of the exceptionally favourable opportunities which the world depression presents for borrowing at cheap rates. For it is a matter of agreement among economists that one persistent and deep-lying cause of the present depression is to be found in the failure of the owning classes to invest their resources in productive enterprise, with the result that a substantial amount of the money that ought to be flowing into industry, and so

stimulating employment and increasing consuming power, is either lying idle in the banks or being applied to non-productive uses, or even being hoarded as currency. If States had stepped boldly into the breach and borrowed money at the cheap rates prevailing in the short-term capital market, and if they had used this money wisely for schemes of economic development, they could have done a great deal to counteract the present world depression. It may be agreed that it would be far easier for any one State to do this if other States were at the same time pursuing a like course ; and it is important to notice that the International Labour Office has been endeavouring to persuade the States of the world to pursue this policy in concert. Indeed, if the capitalist world desires to escape from the disaster with which it is now threatened, it is clear that one essential step is a concerted international policy of economic development directly undertaken by the leading States. This should include not only the provision of capital for schemes of development at home, but also fresh lending abroad for the stimulation of economic development in the less advanced countries. The need of Russia for foreign capital as a means of development is well known. But, even if the capitalist countries refuse to lend to Russia, there are plenty of other areas which would amply repay large capital expenditure on the development of their resources. Poland, for example, and indeed Eastern Europe as a whole, are at present utterly deficient in railways, in electrical power, and in almost all the vital public utility services on which the growth of an up-to-date economic system depends. The older industrial countries are amply equipped with resources for providing those services which the less developed parts of the world need ; and these resources are at present lying unused for lack of a market. Clearly, if Capitalism is to justify its existence or to hope for a prolongation of its lease of life, it must find means of applying these idle resources to the economic development of the less advanced countries of the world. But this cannot be done without a renewed growth of overseas investment ;

and it seems hopeless to expect that, in the present uncertainty of the world economic situation, the private investor will be prepared to risk his money in distant ventures. There is need therefore both for an advanced policy of wise productive spending at home in the great industrial nations and for large-scale lending by the creditor countries for the expansion of the economic systems of the less advanced areas of the world. Retrenchment in the sense of a contraction in State capital expenditure and in the volume of the employment provided by the agency of the State is the worst possible method of meeting a situation in which the world is suffering not from a lack of productive resources but from a ludicrous failure to make use of the ample resources at its command.

CHAPTER X: ECONOMIC ORGANISATION

§ 1. THE STOCK MARKETS

IN ALL countries which have reached an advanced stage of economic development, the organisation of industry presents many of the same features. There are of course national characteristics of each particular system, and important differences in the legal regulations affecting economic structure from country to country. Names also differ—for example, what is called a joint stock company in one country may be known as a corporation in another—and this variation in names often makes it difficult to present a description of modern industrialism in terms equally intelligible even to English-speaking people in different countries. But underlying the variation in names and the differences in legal systems there is a profound similarity of industrial structure. Nor is this in any way surprising; for the structure of modern industrialism arises directly out of the character of industrial processes, and of the methods of buying and selling goods and raising capital for economic development. These present everywhere much the same problems, and evoke much the same answers. The differences between country and country relate rather to secondary than to primary features of industrial organisation. They are important and in some respects far-reaching;

but it is more important still to stress the uniformity of industrial structure over the greater part of the economically developed areas of the world.

The fundamental condition of modern large-scale production is above all the accumulation of capital into large masses under unified control. This implies, in the great majority of cases, that more than one person must take part directly in the ownership of large-scale business. It is indeed still possible for a single individual to own personally even a large-scale business enterprise ; but this condition is rare and becoming rarer in the modern world. It is even exceedingly uncommon for an individual to operate a large business solely with the aid of borrowed capital in addition to his own. The typical large-scale business of the modern world is owned by a body of stock- or shareholders, most of whom take no active part at all in its conduct, and possess in effect very little control over its operation.

This business of share-holding has been indispensable for the adequate use of the powers of production which the widening of the market and the discoveries and inventions of the past century have placed at men's command. In the early days of modern industrialism, one of the greatest obstacles to the effective use of the new powers was the shortage of capital in the hands of those who had the knowledge and the ability necessary for the exploitation of the new technique of production. For in the days before the legal recognition of the joint stock system in its modern forms the employer eager to develop his business and confident of his ability to find a market for his expanded output on profitable terms was often held up by lack of capital. There were indeed certain ways open to him of applying to his business capital resources other than his own. He could borrow money on his personal security or on that of the business itself—if he could find someone willing to lend to him on these conditions. He could acquire a group of partners, including perhaps some sleeping partners who contributed only money and took no active part in the

conduct of the business. He could even sometimes form a joint stock company almost of the modern type with a considerable body of shareholders associated in the enterprise. But there were in practice considerable difficulties in his way. If he tried to borrow money there was no organised capital market in which he could borrow it by means of bonds or loan stock or debentures. He had to find a banker or a merchant or an individual rich man who was willing to finance him. He could not float a loan on the capital market, and thus enlist the support of the general public. If, again, he endeavoured to form a partnership and to bring into the business the capital of sleeping partners, he was at once in the difficulty that all the partners, even if they played no active part in the business, incurred an unlimited liability in the event of loss. Every one knows the story of Sir Walter Scott's entanglement in the affairs of his publishers, and of the struggle which he underwent during the latter years of his life to pay off the huge liability which he had incurred. Such cases were frequent in the early part of the nineteenth century; and they acted as a powerful deterrent to the investment of money by sleeping partners. And if, finally, the early nineteenth century capitalist did form a joint stock company with a body of shareholders, in the first place he had to find his own public for the shares, with the aid perhaps of a local banker or solicitor; and those who put their money into the business were then treated by the law as partners subject to the same unlimited liability, however small the amount of capital which they had subscribed might be. Nor was this the end of the difficulties in the way of joint stock organisation in the earlier part of the nineteenth century; for, as the law refused to recognise the joint stock company as possessing a corporate existence and persisted in treating it merely as an extended partnership, all manner of absurdities arose when it became necessary for the company to appear before the courts—for example, for the recovery of a debt. The names of all the shareholders had to be cited as partners in the business; and this led to an interminable tangle of legal complication which

made the path of those responsible for the conduct of the company very arduous indeed.

These conditions applied directly to Great Britain ; but very similar difficulties existed in other countries in the early days of modern industrialism. France and some other European countries were fortunate in possessing under the *Code Napoléon* the special instrument of " limited partnership "—*compagnie en commandite* as it was called. This enabled partners taking no active part in the conduct of the business to pay in their capital on terms of limited liability ; and this method has been widely used in continental countries even to the present day. But the *compagnie en commandite* is and was meant to be a partnership among a relatively small number of persons, and not a company including a large number of shareholders. It is a useful instrument for the conduct of fairly small-scale business ; but it by no means serves the purpose of modern large-scale industrial organisation.

The Growth of Joint Stock Organisation. For this a different instrument was required ; and in the course of the first half of the nineteenth century this instrument was gradually shaped and given legal recognition in Great Britain. There was indeed a way, even at the time of the Industrial Revolution, in which what we should now call a joint stock company, with the privilege of limited liability for its share-holders, could be brought into existence ; for it was in the power of Parliament at any time to pass an Act setting up a company or corporation or trust and conferring upon it any powers which Parliament might choose to accord. This method was applied in Great Britain in the eighteenth century in the building of the roads through Turnpike Trusts, and subsequently in the creation of the system of canals which were the most important part of the transport system before the coming of the railways. There were also in existence from a much earlier date privileged joint stock companies for the conduct of foreign trade, such as the East India Company (founded in

1600 in Great Britain) and the similar trading companies of France, Holland and other countries. There were institutions, such as the Bank of England and the Bank of Amsterdam, with charters granted directly by the State. The joint stock structure was not by any means unknown; but the privileges of incorporation and of limited liability could be secured only as a special and quite exceptional concession from the Crown or the legislative authority.

Limited Liability. It is unnecessary to trace out here the stages by which modern joint stock organisation was evolved either in Great Britain or in other countries. It is enough to say that in Great Britain the privilege of limited liability was conceded to joint stock concerns in every type of business in 1855; and that thereafter the joint stock system spread rapidly over the whole field of large-scale business organisation. At the same time the capital market in the modern sense came into being. Until then, apart from railway stocks, there had been no organised market for the buying and selling of securities, except within a very narrow field. Stock exchanges dealt mainly in Government bonds and in the stocks of a few privileged concerns such as the great trading companies. Stock markets in the modern sense came into being when the practice of industrial investment became widespread, and the typical large business was owned not by a few partners but by a large body of shareholders, most of whom were interested in their shares solely from the standpoint of dividends and possible capital appreciation.

The conveniences of this modern system of joint stock organisation are obvious. The great benefit of having the ownership of a company divided up into shares of small denomination, and of the existence of organised stock markets on which these shares can be bought and sold, is to make invested capital liquid in the sense that the owner of industrial shares can always sell them at a price. Furthermore the division of the ownership of businesses into shares greatly facilitates the division of estates at death

among a number of inheritors, both because the shares can be more easily thrown on the market in case of need, and because it may not be necessary to market them at all if they can be parcelled out among the legatees. Limited liability possesses even more obvious advantages; for without it any far-flung system of share-holding would be out of the question. If a man who invested—say £5 or £100—in a business thereby made himself liable up to the whole of his fortune for the business's debts in the event of its failure, obviously he could afford to risk investing only in businesses of whose affairs he had full knowledge, or of whose stability he was very sure. But this necessity for caution would have made the mobilisation of savings in the hands of the public for the development of industry an impossible task. Nevertheless for a long time the State fought shy of granting the privilege of limited liability; for it seemed like allowing the owners of businesses to repudiate their contractual obligations. It took a long while for Parliament and the law to realise that limited liability was indispensable not only to peculiar concerns such as railways but to large-scale business enterprises of all kinds, because under no other conditions could the huge masses of capital required for the expansion of industry possibly be made available.

The Uses and Abuses of the Stock Market. But while modern Joint Stock organisation with its division of the capital of business concerns into shares and bonds of small denomination has been the most important means of making a sufficient supply of capital available for the development of industry, and has been a very great convenience to the owners of capital in making their reserves more easily divisible and more readily transferable into money, the system possesses considerable disadvantages and dangers as well. For the stock market is not only a very great convenience for those who wish to turn ownership of things into the command of ready money by the sale of stocks and shares, but also an institution which makes possible the

speculative manipulation of capital values on a scale previously unknown. The stock markets of the world are not and could not be merely agencies for transferring the ownership of shares and bonds from one person to another ; for, if they confined themselves to this type of service, it would be bound often to happen that no one wanted to buy on a particular day just those shares which an individual investor desired to sell, and no one had just those shares for sale which an individual investor wished to buy. This difficulty has been got over by the existence in all organised stock markets of a body of professional operators—" stock-jobbers " as they are common called—who are prepared to make a market at any time in any class of shares quoted on the exchanges in question. The stock-jobber, within the range of the particular classes of shares and bonds in which he operates, is always prepared to buy at a price and to sell at a price ; and it is by this means always possible for the ordinary investor who owns shares or bonds to find a market for them. At any moment considerable masses of stocks and shares are changing hands, and a considerable body of them is held not by the ordinary investor but by the professional operators who speculate in them on their own account. The stockbroker properly so-called deals only on commission, and buys and sells not on his own account but solely on behalf of his clients. The stock-jobber on the other hand operates on his own account, and thereby serves as a means of making a market for the brokers and their clients.

Now an investor, in the ordinary sense, when he buys a share or a bond, is concerned with the income which this share or bond is likely to yield him. If he buys in ordinary circumstances he does so because he thinks that the investment is worth while from the standpoint of the expectation of income to be derived from it in future years. The capital value of stocks and shares is ordinarily and at bottom based on the expectation which people have of their capacity to yield income in the future. The stock-jobber, however, is unlike the ordinary investor in that he usually buys stocks

and shares not with the intention of holding them but rather with a view to selling them again in the immediate future at a profit. He is a dealer in stocks and shares ; and stocks and shares are to him not investments made for the sake of the income which they are likely to afford but commodities to be bought and sold at a profit. He is therefore concerned far more with the capital value at which they are likely to change hands in the stock market in the near future than with their long-run capacity to yield income ; and it will be worth his while to buy a stock, even if he does not believe in its long-run income-producing capacity, provided that he thinks that during the next few days or weeks it is likely—owing to mis-judgement on the part of the public or to similar judgements to his own by other operators —to appreciate further in capital value.

Of course this attitude is not confined to inside professional operators on the stock exchanges. It applies fully as much to the large number of outside operators who are not members of the exchange but are equally professionals concerned with speculation rather than investment ; and it applies also to any section of the capital-owning public which develops at any time a speculative turn of mind, and takes to buying stocks and shares with a view not to long-run investment but to speedy sale at a profit.

The Outside Speculator. If dealing in stocks and shares from this speculative point of view were confined to the inside professional operators, it would probably do more good than harm. For it is, as we have seen, an indispensable condition of the ability of the owner of stocks and shares to find a ready market at any time. But the incursion of the outside professionals and of the general public into this form of speculation radically alters its effects ; for this incursion is highly intermittent, and they are exceedingly apt to be carried away by speculative mania in times of boom. Thus in the New York Stock market boom of 1929 the yield of favoured industrial stocks was pushed down through the speculative rise in capital values to well under

2% before the boom showed any sign of breaking. As at the same time it was possible, even on the New York stock market, to buy high class bonds yielding a 5% return, it is obvious that the purchase of industrial stocks and shares was being made not with a view to their real income-producing capacity, but almost solely with a view to their further capital appreciation, on the assumption of the continuance of the speculative mania. Every buyer was in effect gambling on other buyers' insanity ; and huge paper fortunes were being made, not because the real income-yielding capacity of industrial stocks was increasing, but solely because their capital value was being pushed up to absurd heights by speculators who intended to get out of the particular stocks which they bought while the going was still good. Such a situation was inherently and fatally unstable; and it was far more disastrous under American conditions than it could have been in any other country because there was a far larger public in the United States with free money available for use in speculation. Literally millions of people had their fling on the New York stock market during the boom of 1929 ; and the effect of their incursion was proportionately great.

Moreover, the amount of money that either professionals or outsiders can use in speculating on the stock market is by no means limited to the amount of free money which they actually possess. In the first place, they can pledge securities which they already hold, and so get bank credits which they can use in speculation. Nor is this all ; for in all the leading stock markets the practice has also developed of allowing transactions " on margin." By this is meant that a buyer of shares is not called upon at any stage to pay over the full price of the shares which he buys, or even necessarily to buy any shares at all. He has merely to deposit a sum of money sufficient to cover the estimated likelihood of fluctuation in the capital value of the shares, at the same time giving his broker instructions to sell if the shares fall to such a point as to threaten his " cover " with exhaustion. He can go to his broker and say, Undertake to buy these shares for me at

their current value ; if at any time their capital value rises from x to y sell and hand me over the profit on the transaction ; if, on the other hand, the value of the shares fall from x as low as z, sell and use the " cover " which I have deposited to meet the loss. Stock market dealing of this type is pure gambling on the anticipated fluctuation in the market prices of stocks and shares. It involves no real transfer of the ownership of shares from one person to another ; and there is accordingly no reason why it should be limited to the number of shares actually available for sale in the market. It can be pushed to any lengths, provided that the professionals and amateurs can get either their banks or anyone else to grant them the necessary credits ; and in the New York stock market boom of 1929, while the Federal Reserve System was doing its best to check the creation of large speculative credits for this purpose, its efforts were ineffective because large funds, both domestic and foreign, were flung into the stock market by agencies outside the control of the Federal Reserve System. Financial and business houses of all sorts and private speculators used both their own resources and all the money they were able to lay hands on for purposes of speculation ; and the attempts of the Federal Reserve System to stop the inflation of credit resulted far more in restricting advances to industry, and thereby preparing the conditions for a slump, than in really checking the speculative movement.

Can Speculation be Prevented ? Unhappily it is impossible to have organised stock markets without the risk of having speculative booms as well. For the stock market, if it is to fulfil its appropriate function of making a market for shares in the hands of ordinary investors, must be open to the general public as well as to the professional operators ; and no one can stop the general public from substituting speculation for investment if it has a mind. This is not intended to absolve the professional dealers from a large share in the responsibility for speculative movements. For the professional operator necessarily and in the course of his

business gets into the habit of thinking of share values in terms of short-run capital valuations rather than long-run expectation of income ; and he himself develops under these circumstances a highly speculative turn of mind. Professional stock exchange operators are extraordinarily susceptible both to overconfidence and to panic ; and every day, largely through their influence, we see stocks and shares written up and down in accordance, not with any real change in the legitimate expectation of income from them, but with passing moods of political and economic confidence and mistrust that sweep over the great financial centres at every piece of news even remotely connected with the fortunes of industry. We have seen how, at times of boom, a great mass of new speculators rushes into the stock market and buys and sells with a view not to long-run investment but to short-term capital appreciation. It follows that when for any reason a stock market boom breaks there has to be a tremendous movement of liquidation. Thus speculators who are not habitual operators on the stock market, but have been attracted into it by the exceptional prospects of capital appreciation during the boom, want to get out as soon as conditions change, and are lucky if they get out quickly enough to avoid very great loss ; and apart from this folk who have been speculating on margin or buying securities with bank advances against the deposit of their securities with their bankers either find the money which they have been using for transactions on margin exhausted or get word from their bank that, owing to the fall in the value of the securities they have deposited, the bank must ask either for further cover or for the repayment of their loans. The speculators can only get the money for this repayment by throwing their shares on the market ; and accordingly a great mass of shares is simultaneously put up for sale. This greatly accentuates the fall in share prices, and involves the speculators in very heavy loss. With or without bankruptcy they get out and take their losses ; and thereafter the stock market presents an extraordinary contrast to its previous activity. For, whereas before it was

teeming with buyers eager to force up the price, now there is almost no one who wishes to buy, even if the income-yielding capacity of the stocks and shares at the prices at which they are offered seems exceedingly attractive. For, even if the prospects in terms of income look good, no one trusts the shares not to depreciate further in capital value. This is largely because any period of liquidation following the end of a boom leaves banks and other financial institutions with large blocks of securities on their hands—either securities they have received as collateral against loans which their debtors find themselves unable to pay, or securities which they have bought themselves in the course of speculation. The banks and financial institutions want to market these securities in order to get their resources back into a liquid form ; but they realise the disastrous consequences of trying to sell them all at once. Accordingly the movement of liquidation continues for a long time after the collapse of the boom, as fresh blocks of securities are flung on the market, either on the occurrence of what seems a favourable opportunity, or because the financial necessities of one bank or financial institution after another compel it sooner or later to liquidate regardless of loss. Thus, after the collapse of 1929, the movement of liquidation in America went on right through 1930 and 1931 ; and exceptional measures had to be taken to check its continuance to the accompaniment of a widening circle of bank collapses even in 1932. President Hoover's Finance Reconstruction Corporation was formed at the end of 1931 for the purpose of taking over vast blocks of securities still in the hands of the banks, in order to prevent the flinging of these on the market from causing a still further depreciation in the prices of stocks and shares.

The organisation of modern business on joint stock lines has thus brought with it very considerable disadvantages by making easy vast movements of speculation which serve to divert money from industrial enterprise and to upset the financial basis of the industrial system. It is true that there were great speculative movements long before

the coming of modern industrialism—in France at the time of John Law and in England at the time of the famous South Sea Bubble and the Scottish Darien project in the early part of the eighteenth century. Man did not begin to be a speculative animal only after the Industrial Revolution. But at earlier times the volumes of stocks and shares in which it was possible to speculate was relatively small; and the public with free money available for speculation formed a much smaller section of the community than it does to-day. While, therefore, John Law's adventures in France and the South Sea Bubble in England resulted in spectacular dislocations of business enterprise, their influence was not much felt in the industrial life of either country as a whole. A considerable number of people were ruined; but outside the capital cities industry and trade went on not much affected by the doings of London or Paris. The modern speculative mania has far more disastrous and widespread effects not merely within the country in which it arises but, owing to the international character of modern finance, over the world as a whole.

Nevertheless in some form joint stock enterprise is an essential condition of modern capitalist business. As long as the capital used in industry continues to be for the most part privately owned, it will have to be held through large joint stock concerns with great and scattered bodies of shareholders who take for the most part no share in the conduct of the business. There is indeed the alternative that the capital of industry should be collectively owned by the State itself; and we shall have to consider this alternative at a later stage. But for the moment we are remaining within the assumptions of the capitalist system and it is clear that under this system joint stock is the only possible form for the great mass of large-scale business enterprise.

§ 2. THE JOINT STOCK SYSTEM

JOINT stock companies and similar bodies are of course of many different types. When the joint stock system was first introduced, and even when the privilege of limited liability was granted over a wide field, it was generally believed that the joint stock method would be applied only to very large enterprises which could not get enough capital without appealing to a wide mass of shareholders. It was not intended that small businesses should be brought under joint stock organisation, but rather that they should remain business partnerships without limited liability or the division of their ownership into transferable and publicly marketable shares. Both limited liability, however, and the division of the capital into shares possessed such obvious advantages that the joint system very soon spread to other forms of enterprise besides those for which it had been originally designed. Take, for example, the case of family businesses. If a family business was reconstructed as a joint stock company, it became far easier for the head of the business to divide his property at death among those whom he wished to benefit by giving them shares ; and he was able to do this without any risk of leaving his business short of capital through enforced liquidation in order to pay legacies. Moreover, it is of obvious advantage to everyone to have his liability limited ; and partnership, save in the peculiar form of the *compagnie en commandite*, everywhere involves unlimited liability. This is because a partnership is, in the eyes of the law, simply its members, and has no corporate existence apart from them ; whereas a company, by virtue of its incorporation, becomes a separate " legal person " with a power to take action, to incur debts, and to possess property, apart from the powers of the individuals who hold its shares. The more modern business has become impersonal—that is to say, less the expression of the commanding personality of a single head and more a collective concern in whose service many people are engaged—the

less appropriate the conditions of partnership have seemed to its conduct, and the more appropriate its incorporation under the joint stock system. Therefore, during the latter part of the nineteenth century, joint stock enterprise was constantly extending its range ; and though the law for some time looked askance on "one-man" companies and family businesses which assumed the company form, in the end it was compelled to give full recognition to the accomplished fact.

The Private Company. Thus in Great Britain, under the Companies Act of 1907, the private company was recognised as a distinct type. A private company was defined as a company, with not more than fifty shareholders, which made no public appeal for subscriptions by way of prospectus and restricted under its articles of association the transference of its shares. This last was, of course, indispensable in order to ensure that the number of shareholders should not pass beyond the maximum of fifty laid down in the Act. If, by any means, the number of shareholders did come to exceed fifty, the company automatically ceased to be a private company and became a public company subject to the old conditions.

Under the act of 1907 the growth of private companies took two main forms. The first was the conversion of a large number of relatively small private and family businesses into joint stock concerns. Many small factories and trading businesses, including a large and growing number of ordinary retail shops, assumed a joint stock structure. But in the second place the Act had a consequence which was not at all in the minds of its original promoters. For the great joint stock companies, which were public companies in the full sense, soon began to find it convenient to conduct a part of their operations not directly but through the creation of subsidiary concerns which were registered as private companies under the Act. Thus Company A, a public company, which published a balance sheet and appealed to the public for subscriptions, used a

substantial part of the capital subscribed by the public for investment in Companies B, C, D and so on. These subsidiaries might be either manufacturing concerns providing the parent company with some of the goods which it required for its main business ; or they might be trading companies formed for the purpose of marketing the goods of the parent company either generally or in a particular market. Sometimes this process went so far that the parent company became nothing more than a holding company conducting the whole of its business through its subsidiaries, and itself merely distributing among its shareholders or placing to reserve the profits paid over to it as dividends by these subsidiaries.

This form of organisation was found highly convenient at a time when the ramifications of large-scale business were steadily increasing, and when there was coming into existence a pronounced tendency both towards vertical integration of processes and towards the elimination of middlemen by the large producing concerns through the development of their own organisations for marketing. Thus an iron and steel concern might acquire through subsidiaries coal mines, iron ore deposits and other sources of materials needed for its main productive business ; while a boot manufacturing company might, through one or more subsidiaries, set up a chain of retail shops. Again, a company operating largely in international markets might find it convenient to work through subsidiaries registered in a number of different countries, each under the separate law of the country in which it was intended to work. Often again, two big companies might join together to acquire a third as a joint subsidiary, and this third company might in turn hold the shares of several others : so that the company system as a whole tended to present a more and more bewildering maze of interlocking shareholdings and controls by means of which the half-dozen people at the head of some one great business brought under their control far larger masses of capital and productive resources than belonged to the business of which they were directly in charge.

This building-up of inter-related and subsidiary organisations within the joint stock structure was not wholly bad ; but like the joint stock system itself it was liable to serious abuses. For just as the joint stock system arose naturally out of the requirements of the business world in the middle of the nineteenth century, so this interlocking system of business enterprise has grown out of the more recent technical requirements of business organisation. It is often technically desirable for a number of different productive concerns to be brought under unified financial control, in order to secure the economies which can be achieved by vertical as well as horizontal combination. There is a case for steel works owning their own coal mines, or for productive concerns dispensing with middlemen and seeking to sell directly to the public. For these reasons it is out of the question to attempt to stop the movement towards the creation of subsidiary companies and interlocking business organisations.

The Abuses of "Big Business." But the abuse of the system has been seen very clearly in recent years. It is under modern conditions usually a good deal easier for large than for small businesses to raise capital or to get accommodation from the banks. In times of prosperity and overweening business confidence a tendency therefore develops for big businesses to raise from the public far larger masses of capital than they can possibly need for their own productive enterprises, and then to use this surplus capital in buying up other businesses right and left, often at inflated prices which are the result of the over-confident mood of the moment. As long as these purchases are confined to businesses which can effectively be brought under unified management and control, no great harm may be done unless too much is paid for them. But it is fatally easy for the man or the few men at the head of a great business to get megalomania, and to start buying concerns which require a quite different basis of knowledge and technique of administration, and cannot be effectively unified with the parent

business. Huge agglomerations of diverse businesses of this type are seldom or never economically administered. The attempt to control them from a common centre breaks down ; and some one of the subsidiaries, as in the famous case of the late Lord Leverhulme, loses millions, while the heads of the main business happen to be looking the other way. Hugo Stinnes is the outstanding example of this type of megalomaniac agglomeration of business controls ; and his vast concern broke down hopelessly as soon as his controlling hand was removed.

It should be clearly realised that the Stinnes and other similar concerns broke down in the main, not because they were too big, but because they were too heterogeneous. There is nothing necessarily against very large business units, which may not even be harder than smaller units to administer, provided they are reasonably uniform and call for the same qualities of technical and business knowledge. An increase in the size of business units is one of the necessary consequences of the modern economic system. The agglomeration of unrelated businesses into huge concerns of the Stinnes type is one of its speculative abuses. A sharp distinction needs to be drawn between these two types of modern large-scale concern. Thus Imperial Chemical Industries Limited must not be tarred with the same brush as the Stinnes concern ; for it is a reasonable attempt to establish unified control over fairly homogeneous types of industry.

This extension of the scope of modern business organisation is obviously connected very intimately with the rise of trusts and combines, and with the movement known as "rationalisation." But before we go on to the study of these things it is necessary to get one point clearly into our minds. Industrialism grew up in the earlier part of the nineteenth century under conditions in which the business unit and the productive unit were normally one and the same. The actual factory or plant which was the unit of production was at the same time the unit of business organisation ; and it was comparatively rare for the same man or group of

partners to own a number of factories and to work them as parts of a single unified business. There were, indeed, instances in the days of the Industrial Revolution of the same man owning, or being concerned in the ownership of, a number of different factories. Thus Richard Arkwright had cotton mills in a number of different places; but each of these mills was operated, often in conjunction with a separate body of partners, as a distinct business concern, and there was no attempt to establish over all the different productive plants any unified financial control. Even much later in the first half of the nineteenth century the financial and productive units continued as a rule to coincide; and it was only quite late in the century that the divorce between them became at all common with the growth of the combination movement.

§ 3. TRUSTS AND CARTELS

There were three main reasons why this linking up of separate productive establishments into larger business units tended to take place. It happened sometimes through the desire of a manufacturer or a joint stock company to bring the supply of the materials which it used under its own control and so get for itself the profits on a second stage of production, besides ensuring itself of regular supplies, and contracting out of the vagaries of raw material prices. Movements of this sort are generally called *vertical* combination—that is to say, combination which brings together under unified control two or more successive stages in the process of producing goods. This vertical combination may be applied at any stage; and a firm may either reach back towards the control of its supplies of material or forward towards the ultimate market in which its goods are to be sold.

With *vertical* is usually contrasted *horizontal* combination

—that is, the combination into a single business unit, or into a more or less closely knit association, of a number of firms all concerned in the same type of production at the same stage. The motive behind combination of this kind is quite different. It has been in the past usually based on the desire to limit market competition and to secure the means of regulating either the prices at which goods are to be sold to the consumer, or the quantities to be placed on the market, or the conditions under which sales are to take place. Horizontal combination, unlike vertical combination, thus tends to have a directly monopolistic character. Vertical combination commonly creates side by side a number of competing businesses, each covering several stages of the process of production, and each in competition not only with the rest but also with other producers at each stage. It is monopolistic only in the sense in which all large agglomerations of capital are monopolistic. But horizontal combination can usually serve little purpose unless it includes a sufficient proportion of the producers of a given type of goods to give those who belong to it some degree of effective control over the conditions of marketing by the regulation of either prices or output. It is, of course, true that, if a combination regulates prices and fixes minimum price levels below which no sales are to be made, it thereby also restricts output automatically; for any raising of prices will choke off a certain number of potential buyers. On the other hand, any combination which restricts output thereby also does something automatically to regulate prices; for usually the less it produces the higher will be the price it is able to charge. Output regulation and price regulation are only two different methods of seeking to accomplish the same end—an increase in profits through the regulation of the conditions under which goods are placed on the market.

Does Combination Raise Prices? It is, however, especially in recent years, often contended that horizontal combination serves another purpose besides that of restricting

prices and output. It is argued that it can be so used as to lower the cost of production, and thereby instead of raising prices actually to make them lower than they would be if the combination did not exist. It is, of course, common knowledge that, under modern conditions of production, factories tend to produce at lowest cost when they can keep their plant fully employed, and that there is usually an economy in manufacturing processes in the turning out of large masses of uniform standardised commodities. Both these forms of economy, it is urged, can be forwarded by the formation of horizontal combines ; for in the first place, if the total market demand is inadequate to keep all the factories fully employed, it will be economically more advantageous to close some of them down altogether and to keep the remainder fully at work than to spread the available volume of production over all the establishments. A horizontal combine is in a position to shut some of the factories down altogether and to concentrate production upon the remainder, and in this way to lower costs and perhaps by selling at lower prices so stimulate demand as to bring some of the disused factories back into operation. Moreover, a horizontal combine can arrange to standardise products far more than is possible under conditions of competitive production. If a number of separate producers are turning out goods without co-ordinated control, they will usually produce a wide variety of different styles—possibly far in excess of any real benefit which the variation confers on the consumer. A combine can cut down the number of varieties and thus lower the cost of production, conferring on the consumer by way of lower prices far more than he loses by some restriction in his range of choice. There are of course dangers in this standardisation, which may result in the destruction of valuable varieties. But it is beyond doubt that many of the variations in modern production are of no conceivable value to the consumer, but on the contrary are of positive disadvantage. The standardisation of the size of screws was one clear case in which the consumer gained by a reduction in the number of different types of manufacture ;

and there is no doubt that in Great Britain the multiplicity of small makers of different types of motor-car stands seriously in the way of the effective development of the industry from the consumers' standpoint. A cheap car which could combine all the patent gadgets of all the rival manufacturers, or rather one that combined the best possible selection from among them, would be of far greater benefit to the consumer than the present multiplicity of types and styles.

Nor is it only by means of standardisation and simplification of products that a horizontal combine can achieve economies; for even if there is to be no change in the variety of goods produced there may be considerable economy in concentrating the production of each variety in a single factory, where it can be produced on a mass scale, instead of having a number of separate factories each producing a part of the total supply of many different classes of goods. Where large horizontal combines have come into being in recent years, this specialisation of factories to particular types of production has been one of their more important features; but in practice standardisation and specialisation have usually gone together.

The Growth of Standardisation. It may of course be argued that the advantages of standardisation, and even many of the advantages of specialisation, can be secured without the necessity for business combination. A body such as the Chartered Standards Institution in Great Britain has succeeded in getting certain standards of production very widely applied even among businesses which are in no way financially unified. Thus the kinds and types of steel manufacture in Great Britain have been very greatly influenced by the standard specifications which have been laid down and then incorporated as conditions in contracts entered into between steel producers and their customers. Certain types of steel, once manufactured on a large scale, have practically disappeared from the market in favour of superior types, largely because of this method of standard

specifications embodied in all important contracts. It is, however, difficult to press the movement for standardisation or specialisation very far without some degree of financial unification. The United States with its enormous producing area has done a great deal in this way by the interchange of information among independent manufacturers and the recommendation of productive standards by central technical bodies. But it is usually found that the economies of specialisation, at least, cannot be secured without a high degree of financial unity ; and the possession of patents by a large number of separate businesses stands effectively in the way of securing any high degree even of standardisation by these means. Consequently to the desire to control the market by regulating prices and limiting output there has been added more and more in recent years the desire to achieve economies in production by way of standardisation and specialisation, and these two forces have gone hand in hand in promoting industrial combination.

Combination when it occurs may have many different forms and degrees of intensity. It is most intense when the combining businesses are brought together into a single business under fully unified financial control. The different plants may continue to be operated under separate managements, and these managements may be given a fairly wide autonomy in their conduct ; but the general business policy of the combine in such matters as the regulation of prices, output and types of manufacture will pass in this case under the unified control of the central organisation of which the separate factories will become only branches. There will then be many factories, but only one business. This form of organisation, which is commonly called the Trust, may be achieved in a number of different ways. All the separate businesses may be wound up and amalgamated into a single business ; or they may be left in separate existence subject to the control of a holding company which appoints their directors and holds the majority of their shares. But in either case the object is the full unification of

business policy, combined with such degree of decentralisation in productive management as the circumstances of the particular industry may seem to require.

The Cartel. In contrast to this form of unified business organisation stands the cartel type of association. In this the separate businesses retain both their distinct existence and their ultimate independence, and merely come together for federal action in certain matters of common importance to them. They may, for example, enter into an agreement for the regulation of prices or output, or even for the sharing out of the total available orders in such a way as to make possible a high degree of specialisation in each particular business. They may agree to adopt standard specifications in all their output in order to reduce the number of varieties ; and they may make some sort of agreement for the geographical delimitation of markets on either a national or an international basis. They may, further, in the more intensive type of cartel, establish a common sales organisation, through which all the members agree to market some or all of their products ; and this sales organisation may in certain cases acquire so great a degree of control over the operation of the industry as to exert practically all the powers of a fully unified trust. Where this is so, the cartel is in effect much the same as a trust, but with the significant difference that it is not based upon irrevocable agreement ; for the firms which enter a cartel can in most cases leave it, at least on giving any notice that may be specified in the cartel agreement, and perhaps subject to certain penalties as well. Moreover, the cartel itself can at any time be brought to an end by agreement among its members, or by a failure to carry a sufficient number of votes in favour of its renewal.

Cartel agreements are usually made either for a fixed period of years or subject to reconsideration at stated intervals. Cartels are therefore in this respect profoundly unlike trusts, which are final and irrevocable amalgamations of separate businesses to form a single financial organisation.

This, indeed, is not quite true when the cartel is actually

formed under the authority of the law. There exist in Germany compulsory cartels, to which every producer in a given type of business is compelled to belong; and the British Coal Mines Act of 1930 established something in the nature of a compulsory cartel for the regulation of prices and output among the British coal-owners. But the Coal Mines Act was a temporary measure, although it can of course be renewed; and there is usually in cartel arrangements, even of a compulsory sort, no such guarantee of permanence as exists where the separate capitals of a number of businesses are completely merged in a single new concern. It may, indeed, be most unlikely that the State will allow a compulsory cartel to be dissolved; and the permanence of cartels of this sort may thus be virtually guaranteed within the national frontiers. But this cannot apply to cartels which bring together the manufacturers of several different countries; for there is no "Super-State" either to enforce membership or to secure continuance. All international cartels are voluntary and terminable agreements made only for a limited period.

When the International Economic Conference met at Geneva in 1927, it had under consideration the attitude which ought to be adopted by the various States towards the growth of cartels and other forms of industrial combination, both on a national and on an international scale; for since the war there has been a very marked tendency for the cartel form of industrial combination to expand beyond national frontiers and to take shape in agreements between the organised industries of various countries for a collective regulation of output and delimitation of markets. There were examples of this type of organisation before the war—notably the International Rail Makers' Association, which has been revived since the war, without the participation of the Americans, as the European Rail Makers' Association, and effectively controls the supply of steel rails over the greater part of the European market.

The Steel Cartel. But the outstanding example of international cartel organisation since the war is the Continental Steel Cartel, which includes representatives of the organised steel industry in all the important steel-producing countries of Europe except Great Britain. This body regulates the output of steel within the various national groups by means of a quota system with fines for any country which exceeds the allotted quota and bonuses for any deficiency of production below the quota. Originally set up in 1926, it has not worked by any means smoothly ; but its existence has been renewed and there seems to be a general feeling amongst the European producers that, while they are not satisfied with the cartel as it is, they are not prepared to face the consequences of abolishing it in view of the great redundancy of productive capacity in relation to the present size of the market. There has been a great deal of bickering about the quotas allotted to the various countries, and also about the system of fines for excess production ; and the cartel has been more than once threatened with complete disappearance, and has been at times practically ineffective as a regulating body.

The question has often arisen whether Great Britain should or should not join this cartel. The continental countries have been anxious to secure British participation on terms ; but the quota which they have been prepared to offer to the British producers has been much less than the British steel industry thinks itself entitled to receive, and there have also been difficulties over the preferential claims of the British industry in Empire markets. Moreover, the British producers are not, like those of the continental countries, already organised in a national cartel. They have, it is true, a powerful Iron and Steel Manufacturers' Association ; and there exist among them many specialised agreements regulating the conditions of sale of particular products. But they have no general cartel or combination authorised to govern the total output of raw steel, or to allot quotas to the different producers. If, however, the British industry were satisfied with the terms

offered by the Continental Steel Cartel for its participation it would probably soon be able to construct a national organisation of its own closely enough knit to make membership of the international body possible. The real obstacle in the way is that the British industry lays claim to a larger share of the total market than the continental producers are prepared to assign to it.

Cartels and Tariffs. When the international cartel movement began to develop in the years after the war, a good many people were inclined to suggest that the result of it would be, as it grew stronger, to make tariff barriers unnecessary and to substitute for the State regulation of imports through tariffs the allocation of markets by direct arrangement between the various producing groups without any interference by the State. But in fact the matter has not worked out in this way. International cartel arrangements for quotas and the allocation of markets are largely based on the tariffs already in existence, and would probably break down if existing tariff policies were considerably modified so as to withdraw the protection to which the various national industries have been used. Moreover, the international cartel system is difficult to apply except to a comparatively narrow range of highly standardised products, such as raw steel or rails, or certain classes of chemicals, or certain raw materials. It can certainly not be applied in anything like its present form over the greater part of manufacturing industry. On both these grounds it is not likely to have the effect prophesied for it of making tariff restrictions unnecessary or ineffective. It is likely to remain and develop as a permanent feature of world economic organisation, but not so as to supersede the national measures adopted by each country for the regulation of external trade.

The International Economic Conference of 1927 was disposed on the whole to look with favour on both national and international cartels and other forms of combination, because it saw in them the means of advancing towards a

more effective organisation of the economic system—of taking advantage of the opportunities for specialisation and large-scale production, and of reducing the amplitude of industrial fluctuations. It was argued that cartels would be able to prevent overproduction due to errors of judgement by competing manufacturers. They would be able to bring supply into relation with demand and where necessary to hold stocks and slow production down so as to tide over temporary periods of depressed demand. Probably this is true as far as minor fluctuations of demand are concerned ; but the cartel system has shown itself no more proof than competitive production against the world slump. Indeed in certain cases the attempts to prevent minor fluctuations have resulted in the long run in making the major fluctuations all the more disastrous. For when demand first turned sharply downwards the cartels were sorely tempted either, in the case of commodities which could be readily stored, to hold supplies off the market, or in other cases to keep up prices even at the cost of a further restriction of demand. Where stocks were thus held in the anticipation that the slump would not last long, they had ultimately to be unloosed on the market, thus increasing the general glut. For the more total demand falls the longer a given amount held in stock will avail to supply all demands : so that by the time the accumulated stocks had to be let loose they had far more effect in forcing prices down than they would have had if they had been placed on the market nearer the time of their production.

Similarly, even where stocks were not held, the attempt to maintain prices in face of the restriction of demand lowered demand still further, and finally caused in some cases a greater fall than would have occurred if prices had been left unregulated from the first. To say this is not to condemn the cartel system, which probably has the virtue of reducing the extent of industrial fluctuations as long as the causes behind them are manageable. Moreover, we have all to learn by experience ; and if the cartel system had to face another slump like that of 1929 to 1930 it would have

learnt from its mistakes, and would hardly again overtax its strength either by keeping up prices much too high in face of depressed demand, or by accumulating huge stocks without any clear idea of what was to happen to them afterwards.

In any case, the blame for policies of this sort cannot be laid solely at the doors of employers organised in private cartels. Governments have done the same thing in an even more spectacular way. Take the case of the Federal Farm Board in the United States, with its vast accumulations of wheat which for a long time exerted an even more depressing influence on prices by being held off the market—because no one knew when they might be flung on it—than if they had been marketed at an earlier stage. The point is not that cartel organisation is bad, or worse than unregulated competition, but that neither regulated nor unregulated Capitalism has yet found any means of standing out against such conditions as those of the past three years.

Organised Capitalism. It is indeed clear that, if Capitalism as a system is to survive, it is bound to become much more organised both nationally and internationally. Whatever may be the world's economic future, it is certainly not going back to *laisser-faire* of the old competitive kind. If the future is capitalistic, it will be under a Capitalism in which businesses combine much more closely, both nationally and internationally, in order to regulate the conditions of production and marketing, and carry on industry in much closer relation to their various Governments and under a much more pervasive system of State regulation than before the war. Nor will the world escape these necessities by any change of economic system. Russian industry, even more than industry in capitalist countries, is organised in great and closely knit producers' trusts working under the immediate surveillance of the economic organs of the Soviet Union ; and the difference between Russian industry and capitalist industry in other countries is one less of structure than of purpose and the methods of distributing

the product of economic enterprise. Any transition from Capitalism to Socialism will of course involve a much higher degree of economic organisation than Capitalism, with its diffusion of ownership and control, is able to achieve. Each industry under Socialism will become more highly organised and more closely related to all other industries in accordance with a general economic plan. But socialised industries, in the earlier stages at any rate, would seem likely to proceed along the lines of national rather than international organisation—in that each industry would be conceived primarily as contributing to a national economic plan controlled by a particular national State, and international arrangements would have to be made mainly between States rather than directly between industries as happens now under the capitalist system. For Socialism, however international its ultimate objects may be, perforce makes its appearance as a series of national movements for the conquest of economic and political power within particular countries ; whereas Capitalism is free to be either nationalist or cosmopolitan according to the different circumstances of each kind of enterprise. Some capitalist combines, such as the Royal Dutch-Shell concern with its various subsidiaries, are essentially cosmopolitan in their structure; whereas others, also international in their scope, are based, like the International Steel Cartel, on a federation of national and to some extent nationalist groups.

It has sometimes been urged that the cosmopolitan tendency in Capitalism is an advantage to the world because it tends to overpass political frontiers, and to knit the world together so as to make war more difficult. But in practice there is little to be said for this view ; for even the most cosmopolitan ventures tend to be primarily attached to one or other of the great imperialist powers, and it would certainly require too great a stretch of imagination to conceive of oil as an influence on the side of international peace.

§ 4. SHAREHOLDERS, TECHNICIANS AND WORKERS

We have next to consider how the changing structure of modern industrialism with its growth of great combines, its ever-extending use of mass production, and its movements towards rationalisation and its control of the market by artificial means, reacts on the position of the various classes concerned in its working. We have seen that in the typical modern business, with its joint stock structure and its widely diffused ownership of capital, the main body of shareholding owners has ceased to count at all in the control of business policy. The shareholder puts up the money for industrial enterprise, and in due course if the enterprise is successful receives his dividends ; but that, so far as he is concerned, is the beginning and end of the matter. He does not and cannot know anything about the proper way of conducting the various enterprises of which he is part owner. For the normal investor in the modern world spreads his risks either directly by investing his saving in small amounts scattered among a large number of different concerns or indirectly by consigning them to an investment trust or some similar body which performs the function of risk-spreading on his behalf. Even if he is an investor rather than a speculator, and does buy stocks and shares with the idea of holding them rather than of selling them again, he does not usually regard it as being any of his business even to attempt to control the operations of the companies in which he invests. This of course does not apply to very large shareholders, or necessarily to the shareholders in small private companies—although even in their case it applies nowadays to a considerable extent. But the real control of large-scale modern business is in the hands not of the body of persons who own the capital but of a much smaller number of active business men who may sometimes be considerable shareholders in the enterprises which they direct, but need not even be shareholders at all. They are

"captains of industry," remunerated often largely by a salary, though they may have in addition some share in the profits of the undertaking, and the size of their salary is likely to depend in some degree upon its success. They range from financiers, to whom it is largely an accident with what particular branch or branches of production they are concerned, to technicians controlling a great business by virtue mainly of their knowledge of its actual productive working. In Great Britain there has been a marked tendency for the directors of business to be chosen mainly on financial rather than on technical grounds; whereas in German business the technician far more commonly occupies the position of real governing importance. American conditions are too various for generalisation on this point to be possible. But everywhere the controlling influence in modern business organisation is largely financial; and the great mass of those who supply the technical knowledge are primarily salaried persons—employees of the business, and in this respect liker to the manual wage-earners and clerks than to the actual directors of industry or the body of shareholders who live upon its proceeds.

The Attitude of the Technicians. These technicians, however, even if they live on salaries rather than by sharing in the profits of enterprise, are chiefly regarded as belonging to the side of management; and by reason of their class affiliations and upbringing they tend to take the part of Capitalism rather than of the forces making for any fundamental change in the economic system. But there is always the possibility of their changing sides; for as technicians they have also a professional concern in industrial efficiency. They want to see the job done well; and they will tend to ally themselves with any force which seems likely to promote the more effective organisation of industry, provided that it does not too directly threaten their own material interests. As long as they are afraid of Socialism assuming a revolutionary shape, such as to threaten their own bourgeois status, they will be disinclined to range

themselves on its side—provided that they can feel that there is any real prospect of Capitalism continuing to function with tolerable efficiency as a form of industrial organisation. But if at any time they feel that Capitalism is seriously threatened with collapse, and is serving as a positive obstacle to more effective organisation, they will be disposed to reconsider their position, and to ask more seriously than they have yet done whether there is any possibility of building up a more stable and progressive industrialism on a Socialist basis. They have been largely deterred from even asking themselves this question hitherto by a sense that Socialism lacks economic competence ; for Socialists have seemed to be more concerned with altering the distribution of the product of industry than with promoting the efficiency of production. But it is now being realised more and more that production cannot be efficiently carried on unless the problem of distribution can be solved ; and Socialism is beginning to wear a new aspect in face of the gigantic efforts which are now being made to increase and organise production as well as distribution under the Russian Five Year Plan. If Russia succeeds, her success is likely to have far larger results than any amount of propaganda in bringing over the technicians to the Socialist side.

One obstacle to this conversion is that the technician, by virtue of his position in industry, is apt often to come up against the trade unions of the manual workers, and to regard them mainly as bodies which obstruct his efforts to promote greater industrial efficiency. For the trade union in its endeavours to protect the standard of life and the working conditions of its members often finds itself opposing what the technicians want to do in the interests of cheaper production. This is especially true of the old-established trade unions of skilled workers, who often see their livelihood menaced by changes in productive technique which threaten to make their painfully acquired skill redundant. Their unions accordingly are very apt to fight a rearguard action against inevitable industrial changes ; but often the

result of their opposition, even where it is unsuccessful in the long run, is to cause these changes to be made in ways less harmful to working-class interests than if there were no one to put the brake on the attempts of the technicians to cheapen costs. For the technician on his side is apt to regard industry merely as a technical problem ; whereas it is fundamentally a human problem as well, and its object is not merely to create the maximum of goods, but to create them with the minimum of human suffering and inconvenience, and in such a way as to promote the best distribution of wealth. Cheap production is not an ultimate good. It is good only if it leads to right distribution, and if it is limited by the demand of the workers for tolerable human conditions of labour.

The Functions of Trade Unionism. The trade union thus often serves a useful purpose, even when it seems to be taking up an obstructive attitude. But in recent years the technical development of industry has been so speeded up, and the traditional divisions between the skilled crafts have been breaking down so fast on every side, that the obstructive power of the trade unions has been very severely limited—the more so because trade unions are always strong or weak in proportion as the demand for labour is great or small in relation to the supply. In the last few years there has been in almost all trades a redundancy of labour ; and this unfavourable situation for trade union action has coincided with a great speeding up of the rate of technical change. Trade union power has therefore been seriously undermined, though it has been by no means entirely destroyed ; for even in such depressed trades as the cotton industry of Lancashire there exists so high a degree of solidarity as to give it great power even under the most disadvantageous conditions.

There is, however, no doubt that the recent technical development of industry is growingly inimical to the power of trade unionism ; for the strength of the trade union movement is very unevenly distributed over different occupations,

and its main power has in the past resided in certain great unions, such as those of the miners, and in a number of highly skilled and specialised crafts, such as those in the engineering and shipbuilding industries. The extreme depression in coal-mining and the other heavy industries, combined with the growing introduction of mechanical methods which threaten to supersede the traditional skill of the coal-hewer and the smelter, has seriously weakened the trade unions of the miners and steel workers ; while the engineering trades, inflated during the war far beyond their normal personnel, have had to undergo very severe contraction, and at the same time to stand up to a rapid standardisation of methods which has enabled skilled men to be replaced by semi-skilled or unskilled workers in one traditional process after another.

Rendered weak where it was formerly strongest by these changes, the trade union movement in one country after another has largely lost its driving force ; nor could it, even if world prosperity were fully restored, regain its old position without profound changes in its structure and policy.

Trade Unionism and Politics. If trade unionism is again to become as influential as it bade fair to be little more than a decade ago, it will clearly have to reconstruct itself on a new basis—placing less reliance on the power of limited groups of skilled workers, and more on the mass organisation of the entire working class. For not only the lines between craft and craft but also those between skilled and unskilled workers and those between industry and industry are being broken down, so as to make labour far more readily transferable from one industry or occupation to another. The day of sectional monopolies of labour, maintaining a privileged position for the workman of a particular craft or even of a whole industry, has definitely gone by, except for a very few groups here and there ; and the new unionism is bound to be far more a mass movement based on a common industrial policy transcending the boundaries of separate crafts and industries. Trade unionism

has also under the changed conditions tended to become more political ; for whereas the aims of separate crafts and industries often seemed to be capable of the easiest pursuit by means of purely sectional action, demands which are common to the whole working class are bound to take far more a political form. The aid of the State in regulating industrial conditions will be more and more invoked ; and it will become more and more impossible to keep demands for improved conditions of labour distinct from demands for better organisation of industry as a productive concern. For the trade unions, when nowadays they demand better wages and conditions or seek to preserve their established customs against invasion, are commonly met with the denial of industry's ability to pay ; and they as commonly retort that this inability is due to defects of industrial organisation on the employers' part, and that they cannot legitimately be called upon to suffer the consequences of an industrial inefficiency over which they have no control. In one case after another in recent years disputes about wages and conditions of labour have been inextricably mixed up with controversies about the efficiency of industry. This has happened in Great Britain in coalmining, in the cotton industry and in the steel industry ; and in all these cases the trade unions have been found pressing for the adoption of schemes of industrial reorganisation as a means of safeguarding their own wages and conditions, and pressing for parliamentary intervention in order to make these schemes effective. The existence of Labour Governments in Great Britain in 1924 and again from 1929 to 1931 of course greatly reinforced this tendency of the trade unions to appeal to the politicians for help in protecting their conditions ; but the movement was in itself inevitable, and the return of the Labour Governments to office was itself in part a result rather than a cause of the increasingly political character of industrial questions.

§ 5. THE FUTURE OF COLLECTIVE BARGAINING

ALTHOUGH both in Europe and in the United States the recent technical developments of industry have tended to weaken the power of the old established trade unions of skilled workers, and to undermine the monopolies of labour which they had painfully built up, there can be no doubt that over the world as a whole working-class conditions have substantially improved during the past two decades. This is largely due to the circumstances which prevailed during the war, when there was in all countries an acute shortage of labour ; for this shortage naturally had the effect of forcing up wages and bringing about improved conditions, despite the intervention of the State to impose compulsory arbitration and prohibit strikes in order to prevent wages from being driven up still further. Moreover, when the war ended, Labour seemed everywhere to occupy both politically and industrially a far stronger position than in 1914 ; and in most countries employers hastened to make concessions in order to buy off the rising unrest in the organised working class. In Europe and to some extent in the United States the hours of labour were reduced over a wide field ; and wages were raised to a level corresponding to the very high prices of the years immediately following the end of the war. In the ensuing slump, as prices came down, wages were again reduced and conditions worsened ; but in most countries the workers succeeded in holding some part of the advantages which they had gained during and immediately after the war. In particular they held on tenaciously to the eight hours day where it had been secured, and put up so strong a resistance to wage reductions that over industry as a whole these lagged substantially behind the fall in wholesale prices and in the cost of living. In Europe indeed wages were very heavily reduced in certain trades peculiarly exposed to foreign competition, such as coalmining and engineering. But they came down much less in the more sheltered trades

producing mainly for the home market. The only countries in Europe in which the working classes were definitely forced back to a worse position than before the war were those which passed through a phase of extreme currency inflation. In Germany in 1923 the working classes were pushed down very near to the starvation level ; and in France also wage levels failed to rise in proportion to the fall in the purchasing value of the franc. Inflation thus tended to increase the disproportion between the real wages paid to German and French and to British workers at a time when technical changes were reducing the commercial value of the high traditional skill of the British working class. This reacted, even before Great Britain returned to the gold standard in 1925, on the competitive power of British industry in foreign markets.

After stabilisation in Germany, and later in France, working-class conditions in these countries began gradually to improve ; and especially in Germany wages had by 1929 got up to the pre-war standard, and in some cases gone beyond it, despite the reduced hours of labour. In France the advance was slower ; and working-class conditions continued to be bad largely because of the weakness and acute divisions of the French trade union movement. This was split up into two rival sections—one communist and the other moderate—and thereby prevented from taking any effective industrial action. The French workers had to wait for an improvement in their standards for the sharp fall in prices which accompanied the slump ; but this reacted in precisely the opposite way upon the workers of Germany. For under the pressure of Germany's financial difficulties the internal German price level was kept up, while German wage standards were forced down in the attempt to provide an export surplus for meeting the country's foreign debts. These changes in relative real wage standards among the European countries added greatly to the complexities of international trading conditions, and were a factor in aggravating economic nationalism all over Europe.

Wages and Productivity. All this time productivity of industry and of labour was increasing very fast all over the world ; and it is doubtful if anywhere wages and conditions improved as fast as productive power. Productivity rose most of all in the United States ; and it is beyond dispute that there wages lagged seriously behind during the prosperous years which preceded the world slump. American wages remained high—very high—in relation to the wage levels of the European countries ; but they were not high enough to provide an outlet in consuming power for the vastly increasing productivity of the American people.

Each country in the world has its own level of wages and working-class conditions, or indeed perhaps several different levels existing side by side for different sections of the population. But, under the conditions of the modern world, competition in many classes of goods is worldwide ; and these different levels of wages therefore enter very unequally into the costs of producing goods in different countries. In theory the wage level of a country ought to reflect the level of its industrial productivity in relation to that of other countries : so that wages paid at a higher rate in one area than in another ought to be offset by a superiority in productive power. But in practice this does not necessarily happen, for wages do not depend solely on the productivity of labour, but also on the bargaining power of the organised working class ; and it is quite possible for a high productivity to coexist with a low bargaining power. This can happen especially where the high productivity is largely the result of economies in the use of labour through rationalisation, and the substitution of machines for human power ; for in these cases the demand for labour in certain industries is apt to be heavily reduced as productivity rises, and there may be no expansion in the demand for the product of these industries sufficient to reabsorb all the labour which is being displaced by improved organisation. Where this occurs, the rise of wages will tend to lag behind the growth of producing power. Countries in which this takes place will derive an advantage in international competition from

CHANGES IN MONEY WAGES, 1914-1931

Approximate Percentage Rise in Money Wages, 1914–1931	Earnings	Wage-rates
160	Denmark (hourly)	
140	Sweden (daily)	
110	Switzerland (daily)	
90		Canada (hourly)
80	U.S.A. (weekly)	
70		*Australia (weekly)
70		Great Britain (weekly)
55		*New Zealand (weekly)
50		Germany (weekly)
35		France (daily)
30		South Africa (weekly)

*Men only.

COMPARATIVE REAL WAGES IN 1930

(Based on I.L.O. Calculations of Wage-rates and Costs of Living)

Per cent. of British level	
190	United States.
160	Canada.
150	Australia.
110	Denmark,* Sweden.*
100	Great Britain.
90	Ireland.
80	Holland, Switzerland.
70	Germany, Czechoslovakia, Russia.
60	France, Poland.
50	Belgium, Austria.
40	Italy, Spain, Esthonia, Yugoslavia.

*Calculations based on earnings, not rates of wages.

COMPARATIVE RISE IN REAL WAGES, 1914–1930

Per cent. of pre-war level	
145	Sweden.
135	United States
130	Switzerland
120	Czechoslovakia.
110	Germany,† Great Britain.
105	South Africa, New Zealand

†1929

the lowering of their wage costs of production ; but they will also experience a failure of their own home markets to expand in proportion to their ability to produce. Unless, then, they are able greatly to expand their sales in the foreign market they will find themselves unable to use their expanded productive power to the fullest extent. But their attempts to sell the much larger quantity of goods in the world market will inevitably provoke reprisals. Countries which find their own home markets threatened by the exports of these highly productive countries will tend to raise tariff barriers or other import restrictions in order to protect themselves ; while countries which find their exports being ousted from the world markets will be driven to reduce their own wages in order to equalise their competing power. This in turn will react upon their home markets. It is, therefore, a disaster for the whole world when a country in which productivity is rising fast fails to increase its wages bill in proportion to the rise in its productive power. For this will not only set up unfavourable reactions within its own borders, but will also dislocate the economic systems of other countries, exaggerate the tendency towards economic nationalism, and unnecessarily force down competitive wage standards over the world as a whole. In this respect the failure of the United States to raise its own wage standards to a sufficient extent involves a grave responsibility not only for the American slump but also for its reactions on Europe.

The Changing Nature of Demand. There is another way, besides the supersession of manual skill by machinery, in which the modern technical evolution of industry tends to weaken the trade union movement. The strength of trade unionism, as we have seen, has always been concentrated mainly in the heavy industries and in the textile trades. But as the productivity of industry increases the character of its products tends to become far more diverse. As men's standard of living rises, they do not greatly increase their consumption of the great primary commodities, but rather

develop new wants of growing diversity. They buy wireless sets, gramophones, motor-cars and a host of other luxuries which the cheapening of production brings within their range; and they also tend to an increasing extent to buy services rather than actual commodities. They make heavier demands on transport, on the amusement industries, and on restaurants; and they raise the standards of efficiency which they expect from the shops where they buy their goods, and thus cause an increased employment of labour in the distributive trades. For example, shops nowadays have to pack and deliver to the purchasers' homes a far larger proportion of the goods they sell than before the war. These changes in standards of consumption necessarily cause a diversion of labour from the old basic trades to new and smaller trades producing luxury goods, and from production in a narrower sense to transport, distribution and the rendering of services. But labour in these developing trades is far less susceptible to organisation than in the old forms of industry, with their long traditions of collective bargaining and economic solidarity. Trade unionism will doubtless in time find ways of adapting its organisation to the new needs, but in the mean time its influence is inevitably weakened.

CHAPTER XI: THE CHALLENGE OF RUSSIA

1. Before Planning Began
2. The Five Year Plans
3. The Socialisation of Agriculture
4. The Transport Problem
5. Conclusions

§ 1. BEFORE PLANNING BEGAN

SOVIET RUSSIA, with its population of 161 millions and its vast territory of over thirteen million square miles, provides to-day the only working model in the world of a complete system of economic organisation on a non-capitalist basis. There exist, of course, even in capitalist countries, a number of services organised on non-capitalist lines—State-owned post offices, railways, and other public enterprises, a widening range of municipally operated services, special institutions of a semi-public character such as the British Broadcasting Corporation, and a number of State-owned or State-controlled Central Banks, and finally the Co-operative movements of producers and consumers with their far-flung chain of retail stores, their wholesale societies and productive departments, and their numerous institutions for Co-operative credit and Co-operative selling—from small institutions for peasant credit to the Canadian Wheat Pool. But all these institutions in capitalist countries, while they may not be carried on under the full assumptions of capitalist enterprise, are to a great extent influenced in their working by the capitalist environment in which they have grown up. State railways, State post offices, and municipal undertakings may not be conducted for the profit of private shareholders ; but the vast

ECONOMIC CONDITIONS IN RUSSIA.

	1913	1923–4	1924–5	1925–6	1926–7	1927–8	1928–9	1929–30	Last Quarter 1930	1931	Estimates for 1932
Production of—											
Coal, million tons	28.9	16.1	16.2	24.4	31.9	36.3	40.6	46.7	13.1	58.6	90
Oil, million tons	9.3	6.1	7.1	8.3	10.2	11.8	13.5	17.2	5.3	22.3	31.1
Electricity, million KWH	1,945	1,562	2,274	3,517	4,060	5,050	6,600	8,800	2,950	10,600	17,000
Pig iron, million tons	4.2	0.7	1.3	2.2	3.0	3.3	4.0	5.0	1.2	4.9	9.0
Steel, million tons	—	1.0	1.9	2.9	3.6	4.2	4.7	5.6	1.5	5.4	9.5
Cotton Goods, million metres	2,300	832	1,485	1,981	—	2,742	2,825	2,410	595	2,470	3,061
Machinery, million roubles value	—	—	—	—	—	—	1,413	2,120	713	4,700	6,800
Tractors, thousands	—	—	—	—	—	—	4.5	13.4	—	41.7	82.0
Wheat, million tons	20.6	—	18.0	21.3	24.9	21.1	21.6	20.1	—	—	—
Rye, million tons	18.9	—	20.8	23.0	23.9	24.4	19.1	20.2	—	—	—
Indices of Production—											
Agriculture	100	80	84	101	107	106	109	113	—	—	—
Industry	100	48	67	90	103	122	143	180	—	—	—
Total	100	67	77	97	105	116	121	—	—	—	—
	—	—	—	—	80	100	124	153	—	—	—
Wages and Prices—											
Money Wages	—	—	100	125	140	155	170	—	—	—	—
Real Wages	100	—	90	103	115	125	129	—	—	170	—
Wholesale Prices	100	170	179	186	176	172	178	188	187	—	—
Retail Prices	100	198	212	232	203	204	207	216	205	—	—
Socialised Farming	—	—	—	—	—	—	—	—	—	—	—
State and Collective Farms	—	—	—	—	—	—	5.4	32.6	—	51.3	75%
Per cent. of whole cultivated area	—	—	—	—	—	—	—	—	—	—	—
Machine-tractor Stations (number)	—	—	—	—	—	—	—	160	—	1,400	3,100

majority of them are worked with the aid of capital borrowed from private persons, and have to earn interest and sinking fund on these borrowed resources. Moreover, in their relations with their employees and in their pricing policy towards the consumer they are inevitably influenced by the business practice of the capitalist world which surrounds them. There is, indeed, often a persistent endeavour to make them as like private capitalist institutions as they can possibly be made, and to remove their working as far as possible from political influences.

The Co-operative movement stands in a somewhat different position. The producers' Co-operative Societies are, if not always profit-making institutions themselves, at any rate associations of persons working for profit. The Canadian Wheat Pool does not differ in its essential structure and methods of operation from a capitalist combine, although its members are not great capitalists or joint stock concerns, but individual farmers working for the most part with their own hands. Producers' Co-operation is above all a means of organising small-scale producers of a pre-capitalist type into associations large and powerful enough to stand up to the conditions of the modern capitalist world. It is not so much an alternative form of organisation to Capitalism as a semi-capitalist element in the capitalist structure. Its chief difference from Capitalism consists in its greater compatibility with alternative forms of general business organisation. Producers' Co-operation might settle down as an element in a non-capitalist society and adapt its methods to Socialism, as it has adapted them hitherto to its capitalist environment.

Consumers' Co-operation, on the other hand, is a real alternative within its limited field to the capitalist system. It is true that the consumers' Co-operative Societies are financed partly by capital borrowed from their members, on which they pay interest ; but they have eliminated not interest but profit in the capitalist sense, in that they do dispose of the surplus of selling price over cost in the form of dividends not on invested capital but on consumers'

purchases—in other words, by the remission of a part of the selling price. They are also non-capitalist in that they are governed by the democratic vote of their members and that no member can have more than one vote no matter how many shares he holds. But this difference is not practically so important as it seems, for, just as the private shareholder has very little control over the joint stock companies in which his money is invested, the consumer has in practice only a very limited control over the working of the Co-operative movement. He could doubtless have far more control if he wanted it and knew how to use it; but on the whole the Co-operative movement tends to be run by its salaried officials and committees of management rather than by its ordinary members, and even the democratic election of these committees seldom turns on vital differences of policy.

Socialism and Co-operation. Consumers' Co-operation is nevertheless a democratic movement, as far as the nature of its activities permits of democratic control. The real obstacle to its more effective democratisation in practice is simply that its normal operations are not sufficiently interesting to the ordinary member to make him eager to play a large part in their control. But this is a serious weakness; for it means that the ordinary member feels no intense loyalty to his Co-operative Society, and this lack of loyalty very greatly limits the power of the movement to expand to new branches of production. There was a time when enthusiastic Co-operators saw visions of a gradual and peaceable conquest of the whole field of industry by the Co-operative movement, and a gradual supersession of Capitalism by these means without violent change or even the intervention of the State. But no one seriously believes in this view now. Co-operation continues to grow; but its growth offers no vital challenge to the dominance of the capitalist system.

There was a time, too, when ardent Collectivists believed that Socialism could be brought into being by a gradual and piecemeal nationalisation or municipalisation

of industries now under private ownership. States would proceed, they held, to nationalise one by one the leading industries of each country, acting through Social Democratic Parties in possession of political power ; and in this way Capitalism would pass into Socialism by stages, without the need for any violent break. But, although Socialists continue to advocate the progressive socialisation of basic industries and services, I doubt if any Socialist now holds that Socialism is likely to be brought into being by these means alone. For one thing, it is now clearly seen that the process is bound to take far too long, and that the road to Socialism lies less through the piecemeal acquisition of one industry after another than through the establishment quickly of social control over the key institutions of the capitalist world, such as banking and the provision of new capital for economic development. In face of the present difficulties of Capitalism, Socialists are thinking in terms which involve the coming of Socialism far more swiftly than when the assumption of Socialist propaganda was that Capitalism would go on working tolerably enough until Socialism was ready to take over bit by bit the economic institutions of the world.

The Russian Adventure. Therefore in all countries to-day the Russian experiment is being watched with a concentrated attention that has been given to no previous essay in non-capitalist methods of economic organisation. In Russia the Communists have seized power at a blow, and used it for the purpose of building up a complete control over the economic as well as the political life of the vast territory under their authority. But they have done more than this ; for they have not only sought to unify the entire economic life of Russia in terms of a comprehensive scheme of organisation but have also devised this scheme in a form which involves a thorough and rapid transformation of the entire economic life of the country. It would be hard enough to unify in terms of a comprehensive plan the economic affairs of a country already

thoroughly industrialised, and used to large-scale production and exchange. But the Russians set themselves the far harder task of transforming in the space of a few years a huge backward area with a preponderantly peasant population into the most complete and advanced industrial State in the whole world. Nor did they stop short at the attempt to revolutionise the methods of industrial production, so as to equip Russia with a thoroughly modern system of mass production in industry. They have attempted also to industrialise agriculture, and to change the peasant, with his age-long tradition of small-scale production at a very low standard of efficiency, into a unit in a system of industrialised agriculture based on huge farms and the widest possible application of mechanical power. The Five Year Plan, now drawing to a close, and the movement developed under it for the collectivisation of agriculture are the two aspects of this boldly conceived policy of economic development; and it is already evident that in both fields the driving force of the new spirit of Communism has been powerful enough to achieve transformations which almost no one outside Russia was prepared to take seriously when they were first put forward by the Soviet Government. The Five Year Plan may not succeed up to 100% and there may be many difficulties still in the way of collective production in agriculture. But foes as well as friends of the Russian system have to agree that the progress made has been startling almost beyond belief.

Russia and the World. It has been interesting during the past few years to watch, side by side with the progress of the Five Year Plan, the change in the attitude of the outside world towards the Russian experiment. In the early days of the change, opinion in capitalist countries was not merely sceptical but positively derisive. The Russians were laughed at for cherishing fantastic dreams, and their plans were described as fantasies of wish-fulfilment. A complete breakdown of industrial production was confidently prophesied, and mass starvation hinted at as

the consequence of any attempt to interfere with the peasant's control of his land, or to compel him to adopt collective methods of organisation. But gradually this attitude changed under pressure of events. The Riga correspondent of *The Times* and various other inspired "authorities" outside Russia continued to send elaborate messages announcing the imminent collapse of the Russian system ; but these prophesies fell upon less and less receptive ears. There was in capitalist countries a great mass of opinion that hoped ardently for the collapse of the Communist experiment ; but belief that it was actually collapsing grew fainter as the Plan went on, and was even revised so as to make more demands on the productive efforts of the Russian people in consequence of its early success. Opinion in capitalist countries did not become friendly ; but it did become frankly interested, and far less content than before to be put off with mere stories of Russian plots and atrocities, or obviously prejudiced accounts of real or alleged breakdowns in this or that part of the Plan. It became far more eager to get at the real facts, to understand what the Plan was and how it worked, what were the relations between the political Government of the New Russia and the organisation of its economic life, what the Russian people under the formidable discipline of the Plan were really thinking and feeling, how far Communism was in practice really the ferocious dictatorship of a tiny minority over the hostile and reluctant mass, or rather the leadership of a body of men used to working together and knowing their own minds over willing and enthusiastic followers. The tone of political comment upon Russian affairs in the newspapers of Europe and America remained as hostile and even as hysterical as ever ; but the nature and value of the economic information provided began to be modified in deference to the growing desire of the readers of these papers to know what was really happening.

In certain quarters, indeed, the opposition to Russia was strongly intensified by the sense that Communism and the

Five Year Plan were succeeding and entrenching their position. For it was clearly seen that, if a rival economic order to Capitalism could securely establish itself and demonstrate its success in raising the standard of life and preventing unemployment over a large part of Europe, the force of the lesson could not possibly be lost upon opinion in countries still struggling vainly with their economic problems. The success of the Five Year Plan meant not only the secure enthronement of political Socialism over a large and important area of the world, but also a ferment in the minds of those in other countries who had reason to be discontented with the working of the capitalist order. But, although the growing sense that the Russians might be succeeding after all accentuated hostility in some quarters, it had far more effect the other way ; for as the Soviet Union became a formidable force to be reckoned with in the world's economic future it was no longer possible to take up so irresponsibly hysterical an attitude towards it as before. Moreover, the Russians, intent upon concentrating all their energies on making the Five Year Plan and the collectivisation of agriculture a success, were far less inclined than previously to involve themselves in dangerous complications in the outside world. Their propagandist activity in aid of foreign revolutionary movements was relaxed ; and they were inclined, where they saw the chance, to come to terms with the capitalist Powers in order to allow themselves a freer hand internally. They had to secure imports of industrial goods in order to carry through the re-equipment of Russian industry ; and in order to buy these imports they had to sell exports to the outside world. They therefore wanted commercial treaties and trade agreements with the capitalist Powers ; and while their ultimate projects no less than before involved the extension of the Communist revolution over the whole world, in practice their immediate attitude became superficially more nationalistic. They no longer suffered under the delusion that the world revolution might break out at any moment ; and they came to see that for the time being the

most important contribution they could make to it was to consolidate their own position. This made it temporarily more possible for them to live side by side with the capitalist countries without undue jostling ; and the Governments of these countries, whatever their political hatred of Communism, were not in a position to ignore the possibilities of the Russian market, or amid their own economic difficulties to court war. The existence of Russia under Communism became for the rest of the world an accepted fact ; and the Russians for their part became reconciled to the necessity to making terms with Capitalism for the time being.

The Communist Policy. It is, however, quite a mistake to suppose, as some people have done, that Russian Communism has undergone as a result of its experiences under the Five Year Plan any real change in ideology, or become in any sense nationalist in its fundamental outlook. The Communist philosophy of world revolution, based on the doctrines of Marxism, is far too deeply rooted for that. The present phase of concentration on national affairs within the Soviet territory is purely a matter of expediency, and does not proceed from any change of conviction. The Communists are waiting for the world of Capitalism to collapse, sure in their own minds of entering upon its inheritance. It may collapse soon or late ; but they are so certain of the inherent contradictions of Capitalism as a system as to be in no doubt concerning the ultimate outcome. They think of the Soviet Union, not as a great national State sharply marked off from the rest of the world by its existing political frontiers, but rather as a Union of Socialist Soviet Republics capable of indefinite expansion to include new areas as they become ripe for Communism. The ideal of the Communists is in effect a federal World State, governed in accordance with a unified world economic plan. Their own Plan is national merely because their present control is confined within limited though wide political boundaries.

The Russian Revolution and After. What then is this Five Year Plan, and what is the economic system under which it has been conceived? The Communist Revolution in Russia took place fifteen years ago—in November 1917; but for some time after the seizure of power by the Communists nothing was heard of economic planning. As a result of the complete collapse of the old economic order in Russia, which had indeed occurred chiefly before the Revolution took place, the Communists entered upon an inheritance of utter economic disorganisation. The peasants laid hold of the land, breaking up and parcelling out the great estates and reverting for lack of supplies from the towns to the most primitive forms of subsistence agriculture. The factories, chiefly staffed under the old regime by foreign specialists, and deprived in many cases of their controlling heads, lapsed into utter disorganisation and productive inefficiency—the more so because when a machine broke down there was often no means of repairing it, and because the transport system for the supply of materials and the delivery of products was in utter chaos. Famine within, blockade by the outside world, civil war in many of the most productive and fertile regions, rendered any systematic efforts at reorganisation of the economic system of the country hopeless for the time being. The Russians could only hang on like grim death, waiting for the chance to tackle their economic problems if they could but emerge without complete destruction from the immense difficulties which threatened to engulf them.

Under these conditions there was, and could be, no real plan of economic organisation; and what was done was done mainly by instinct—by an instinctive application of Communist principles to the immediate problem of carrying on somehow. This period has been called by the Russians themselves the period of "War Communism." It was marked by the attempt to establish in a host of industries and in factories scattered over the whole territory of Russia a Communist system which had not been adequately thought out in advance, and the application of

which could not in any case have been effectively controlled by the central Government. This was the period of Factory Soviets, carrying on as best they could—of wholesale confiscations of property before there had been any decision as to what should be done with it afterwards—of the driving away of technicians and managers by class-conscious proletarians who proposed to take matters into their own hands—in fact of a pervasive inefficiency of production which would have been fatal to success in any country more highly industrialised than Russia then was, and fatal even in Russia but for the intense will and driving power behind the Communist movement.

Lenin's Policy. It was Lenin above all who realised at a very early stage that Russia, situated as she was, could not possibly hope to advance to the fully socialised control of her economic life at a single step. It was necessary to go back in order to advance later, and to allow the private trader and the peasant a large amount of scope for individual methods of production and marketing until the Communists had had time to organise on a sufficient scale the means of thorough collectivisation. Accordingly to the period of "War Communism" succeeded that of the "New Economic Policy." Private traders again emerged, and were tolerated by the Government and allowed to make temporarily very high profits. A halt was called to the attempt to make agriculture more productive by bullying the peasant; and instead the peasant was encouraged to cultivate the land in his own way, and allowed to profit by the sale of his surplus produce. As the "New Economic Policy" was brought into effect journalists abroad almost everywhere described it as the beginning of the end of the Communist regime, and regarded it as the first stage in a reversion of Russia to a capitalist order. Russia, they said, was after all preponderantly a peasant country; and in the end, in the ordering of Russian affairs, the peasant was bound to have his way at least in a negative sense. No Russian Government could survive if it attempted

to interfere with his freedom and methods of cultivation ; and the logical accompaniment of peasant production would be private trade and the gradual abandonment of the attempt to impose full-blooded Communism even on industry.

But the Russians, although they made large temporary concessions and permitted a re-establishment of private enterprise which appeared to threaten the entire structure they were trying to build up, were quite clear in their own minds about what they were doing. The entire political authority still remained in effect in the hands of the Communist party, working through the Soviet institutions which its closely knit and disciplined organisation enabled it to manage pretty well as it chose. The Communist party felt that it could afford to allow the private trader to resume his operations and to make his profits precisely because it was confident of its power to suppress him again whenever it liked. It even felt that it could allow the richer peasants freedom to produce and sell in their own way, because it was hardly less confident of its power to handle the agricultural problem when the moment came. Accordingly the Communists set to work to use the respite allowed by the " New Economic Policy " for the purpose of building up the collective institutions by means of which they meant to before long to accomplish a fresh advance. The private trader and the peasant producer would have served their turn as soon as the Communist State was ready to set up its own collectivised institutions on a sufficient scale to provide for the economic needs of the country.

Thus the idea of organising the whole economic life of Soviet Russia in accordance with a comprehensive economic plan grew up under the " New Economic Policy." It had indeed been adumbrated much earlier than this, and had certainly been in Lenin's mind from the very outset. The germ of the first Five Year Plan, which Russia is now bringing to completion, is to be found as long ago as 1920. Lenin realised then that, if Russia was to develop an advanced industrial system, this must be done on the basis of an

ambitious and well thought out scheme for the supply of electrical energy over the whole country. For this alone would make possible the growth of large-scale industries and the industrialisation of agriculture, without putting an impossible strain on the transport system. Russian planning was based from the outset upon electrification ; and this adoption of the most modern and mechanised source of power as the foundation of the new industrialism in Russia gave to it from the first its special character and its inclination towards the most modern and highly rationalised technique of production in every industry.

It was not, however, until 1928 that the Russians were in a position to bring their conception of a fully planned economy to the test of practice. For some years before that they had been actively engaged in developing the institutions and the technique required as the basis for the working of a comprehensive plan. The system of " control figures " —that is, of laying down in advance the expected output of each branch of industry and agriculture, and then constantly comparing these estimates with the actual results secured—began in 1925, and has since become an integral part of the economic organisation of the U.S.S.R.

This " control " system is indeed the very basis on which organised planning rests. Similarly, the establishment of the various technical and controlling organisations for each type of production and for industry and agriculture as a whole was being worked out while the " New Economic Policy " was still in force ; and the Russians did not launch their Plan until they felt confident that the essential institutions for its execution were in satisfactory working order. Naturally they have been led, since the Plan was begun, to modify many of these institutions in the light of experience ; but the broad lines of organisation laid down before the planning system was brought into existence have been maintained without essential change.

§ 2. THE FIVE YEAR PLANS

At the head of the entire Russian economic system is the Council of Labour and Defence, which is responsible only to the Soviet Congress and its Central Executive Committee. The Council of Labour and Defence was originally in the main a military body concerned with the defence of the Soviet system against external aggression, and necessarily subordinating economic matters to the safeguarding of the Soviet system itself. But with the ending of civil war the control of the economic life of the country came to be the Council's most important function, and it has been preserved as the final co-ordinating agency to which the specific organisations dealing with industry, commerce and agriculture, as well as the Commissariats providing for the social services, are subject. It is in fact a body representative of the controlling authorities in all the main fields of Soviet economic life, as well as of the Government itself. But it is concerned, not with detailed administration, but solely with the laying down of the broad outlines of policy, and with the clearing up of difficulties and disputes that may arise between the various agencies entrusted with direct administrative functions.

The Council of Labour and Defence, which was formed in 1920 as the first step towards a planned economic system, is in form a committee of the Council of People's Commissars—the " Cabinet " of the Soviet Union. It is in fact the Russian " Cabinet " acting as an economic body. It has therefore no administrative machinery of its own. It issues its orders ; and these orders it is the business of all the administrative agencies of the Soviet Union to carry out. But directly under it is the body which has been under its authority responsible for the working out of the Five Year Plan. This is " Gosplan," the State Economic Planning Commission which developed out of a conference of economic specialists called together by Lenin in 1920 for the consideration of his plan of electrification in its relation

THE RUSSIAN FIVE YEAR PLAN

Projected Increase in the final year of the original Plan over the year before the Plan began (1932-3 over 1927-8)

	Increase per cent. Planned
A. POPULATION	12
Number of Wage-earners	18
Number of Workers in Manufacturing Industry	25
B. CAPITAL AND INCOME	
National Income	101
Total Capital Invested in Industry	200
„ „ „ Power-Plant	430
„ „ „ Railroads	67
„ „ „ Agriculture	35
„ „ „ Urban Housing	41
C. MECHANICAL POWER	
In Industry	143
In Railroads	40
In Agriculture	356
D. PRODUCTION	
Total Industrial	181
Heavy Industries	255
Light Industries	144
Agriculture	151
Coal	112
Oil (Crude)	85
Electricity	253

THE SOVIET PROGRAMME FOR 1932

	Programme for 1932	Planned Increase over 1927–8	1928–9
Capital Investment million roubles	21,000	—	—
Industrial Production, Planned Increase per cent.	36	—	—
Production of—			
Coal, million tons	90	148	—
Oil, million tons	31	164	—
Pig Iron, million tons	9	173	—
Steel, million tons	9·5	126	—
Rolled Iron, million tons	6·7	—	72
Electricity, million KWH.	17,000	237	
Production of—			
Machinery, million roubles value	6,800	—	381
Tractors, units thousands (from 3·2 in 1928–9)	82	—	—
Motor-cars, number thousands (from 1·1 in 1928–9)	73	—	—
Locomotives, units thousands	1·3	—	—
Trucks, units thousands	50	—	—
Cotton Fabrics, million metres	3,061	12	—
Footwear, million pairs	91·5	—	—
Canned Foods, million cans	1,000	—	—
Wages—			
Planned percentage increase	11	—	—
Agriculture—			
Cultivated area, million hectares	144	29	—
New Tractor Stations, thousands	1·7	—	—
Traffic Turnover, million tons	502	235	—
Costs of Production—			
Planned percentage reduction	7	—	—
Cost of Transportation—	10	—	—

to the development of Russian industry. "Gosplan," unlike the Council of Labour and Defence, is essentially a body of experts, and under it are a series of special sections, each concerned with some particular aspect of the productive system, and each drawing up its own plan for that part of the national economy which falls within its scope. It is the function of " Gosplan " to coordinate these sectional plans and to submit them to the Council of Labour and Defence ; but " Gosplan," as an expert body, has itself neither executive nor administrative authority. It draws up plans ; but it is for the Council of Labour and Defence to accept, reject or amend whatever it proposes.

These agencies—the Council of Labour and Defence, and " Gosplan "—are concerned with the whole range of Soviet economic activities, including trade and agriculture as well as industry and transport, and with the planning of the public finances as a whole as well as the financing of economic enterprise in the narrower sense. For under the conditions of Communist Russia public finance and business finance cannot possibly be kept separate. They are two aspects of the same thing ; and a State which aims at organising directly the entire economic life of a country has no budget apart from the operation of productive business such as exists in other States. There is no taxable capacity of the nation apart from the capacity generated in publicly controlled industry itself ; and accordingly the traditional lines of division between public and business finance necessarily cease to exist.

Under the Council of Labour and Defence—that is, under the Council of People's Commissars in its economic aspect—are the various separate organisations for the control of different parts of the national economic life. The most important of these are the Commissariats dealing with agriculture, transport, and trade and the Supreme Economic Council, which is concerned not with the whole range of economic life but only with the productive industries. The council of Labour and Defence is the co-ordinating body for economic activity as a whole ; the

Supreme Economic Council only for the various branches of industrial production.

Trusts and Combinations in Russia. Under the Supreme Economic Council Russian productive industry, developing extraordinarily fast under the Five Year Plan, is organised mainly through a series of "Combinations," each covering a particular branch of production. These "Combinations" are in effect national controlling bodies for whole industries over the entire territory of the Soviet Union. Within them are smaller bodies known as "Trusts," which link together groups of factories in the same branch of production, usually within a more restricted area. Thus, where this structure exists in its complete form, the basic unit is the factory, now under the control of an individual manager appointed with the aid of some sort of representative council drawn from the employees. Over the individual factory is the "Trust," grouping a number of factories for the common supply of materials and the distribution of products. Over the "Trust" in turn is the "Combination," which is directly responsible to, and in effect forms a section of, the Supreme Economic Council.

This structure, however, is not uniformly repeated in all industries. There are industries of secondary importance which are organised on a regional basis, and responsible primarily to the separate Economic Councils of the distinct Republics within the Soviet Union. There are Trusts which are not grouped in Combinations, but act directly under the Supreme Economic Council. There are even small-scale enterprises which are conducted locally under the direction of the smaller local authorities within each autonomous Republic. Thus there is no rigid uniformity of structure ; and the attempt has been made to devise more or less centralised forms of organisation corresponding to the character and needs of each particular branch of industry. Necessarily, however, as all Russian industry is designed to work as part of a single uniform plan, the system as a whole tends to be highly centralised ; but there

has been in practice a tendency, as the Plan has developed, to increase the amount of freedom given to the smaller units within each structure, particularly where it has been found that the attempt to centralise control has led to long delays in the supply of necessary materials and instruments of production while the requisitions from the various factories were being passed from hand to hand through a series of controlling agencies. The Russians would certainly not pretend that their system of economic organisation has reached anything like finality, or that they have fully solved the very difficult problem of combining a centralised planning of output over the whole area of the Soviet Union with the amount of decentralisation required in each case to give adequate flexibility to the industrial structure. They are constantly modifying their methods and organisation in one respect or another in order to achieve this result.

The Idea Behind the Plan. Nor does the Five Year Plan, or even the second Five Year Plan which has recently been prepared, pretend to be a fully balanced scheme of industrial production. It is an emergency measure, designed rather to lay the right foundations for Russia's industrial future than to supply adequately and in balanced proportions the current needs of the consuming public. Under the Five Year Plan the Communists have been endeavouring, with their minds fixed on the future, to force to the utmost possible extent the expansion of productive capacity ; but as they are working with limited resources, both in the material sense and in the supply of skilled workers and technicians, there are severe limits to the volume of things which they are able to produce. If they want to build more new factories, or to increase their output of machinery, locomotives, steel rails, and other capital goods, they can do this only at the expense of producing for the time being less things destined for use in consumption. The more factories they can build and the more they can improve their system of transport, the

faster will they be able to raise in the future the standard of life of the Russian people. But they can do this only at the expense of producing now less finished goods than they would be able to turn out if they were thinking only of to-day. Accordingly, the Five Year Plan was based on a far more rapid expansion of the heavy industries manufacturing producers' goods and of the extractive industries providing raw materials for the heavy industries than of the lighter trades which exist for the direct satisfaction of the consumers' needs. The Communists have indeed recognised the indispensable necessity of doing something immediately to raise the standard of life of the Russian people ; and there has been a very large increase in consumption, which has raised the standard of living of both Russian workers and peasants not merely above the very low level to which it had fallen during the years of economic disorganisation, but substantially above the pre-war standard. But they have not raised the immediate standard of living as much as they might have done, because they have been far more intent on providing for a still higher standard of living when the Plan has achieved its results. The second Five Year Plan still concentrates on the heavy industries to a considerable extent ; but the success of the first Plan has made possible during the second period additional concessions to the immediate raising of the standard of life.

It is doubtless true that this policy of subordinating immediate considerations of welfare to the building up of large-scale industrialism with an eye to the future would only have been possible in a country working under a dictatorship and with institutions comparatively little subject to the pressure of popular opinion. Russia is a dictatorship in the sense that the control of her institutions is in the hands, not of a democracy in the meaning given to the term in Western Europe, nor of outside organs of opinion such as the press which are in a position to work up popular feeling against the Government, but of a highly disciplined body of men and women animated by a long-run political purpose to which they are prepared to subordinate the

immediate future. The Communist Party, with its two million members representing all that is most active and energetic among the younger element in the Russian people, completely dominates the situation, subject only to the condition, well known to its own members, that it must not strain the endurance of the great mass of the peasantry too far. The Communist leaders might have wished, if they had had a completely free hand, to subordinate immediate consumption even more drastically to the consolidation of the new economic order ; and every now and then they have gone too far in this direction and been compelled to step back. But, while this is their mood, they are of course fully aware that the only object of increasing productive capacity in the heavy industries is in the long run to expand the output of consumers' goods and thus raise the standard of life ; for they are working an economic system designed to produce not profits but goods for human consumption. To strike the right balance between immediate consumers' demand and the expansion of productive capacity for the future has been among the most difficult tasks of those responsible for the first and second Five Year Plans.

The Growth of Population. One factor which has counted considerably in compelling the planning authorities of Soviet Russia to budget for an increasing output of consumers' goods has been the rapid increase in the Russian population. Despite the prevalence and freedom accorded to birth control—which in effect extends only over a relatively small section of the whole people—the population of Russia has been rising by leaps and bounds in recent years. This increase, so far from arousing any terrors in the minds of the Communist leaders, is greatly welcomed by them. Russia is a vast, largely undeveloped, country extremely rich in the most diverse economic resources, and at present very thinly populated in relation to the density of population in highly industrialised countries. There is room, say the Communist leaders, for an immense increase

in the number of people in Russia : indeed such an expansion is indispensable if the fullest advantage is to be taken of the economies of large-scale production and of the immense resources at Russia's command. Every Russian who is born is a potential producer whose services can be so employed as to contribute to raising the Russian standard of life. The Communists feel no fear that they will be unable to find jobs for all these new citizens ; for they have within the territory under their control all the resources necessary for the development of a balanced industrial system capable of a high degree of self-sufficiency for the largest population they see any likelihood of having. It is true that they are at present making great efforts to lower the costs of industrial production by means of rationalisation and by the displacement of redundant labour from their factories. The Russian workman is still inefficient by western standards ; and industrial output per head remains low even where industry has been highly mechanised. This, the Communists say, must stop. The standard of output must be rapidly raised and surplus workers squeezed out ; but they feel the fullest confidence in their ability to re-employ elsewhere all the labour that can be displaced by these means, and to find jobs for new citizens as fast as they reach working age. Moreover, as production increases and becomes more efficient, it will always be possible to decrease hours of labour and to allow more holidays, so as to absorb in industry any number of workers who may be available. For Russia is not producing under competitive conditions with the outside world ; and there is no need for her factories or her workers to be unemployed because at no time can it be more profitable for the Soviet as employer to leave men idle than to keep them at work.

This optimistic psychology of the Communists, their confidence in the expansive capacity of the Russian economic system, their freedom from the fears which dominate workmen and employers alike in capitalist countries, are to a great extent the secret of the immense driving power which they have shown during the past few years. To believe in

oneself is half the secret of success—and a substantial part of the difficulties in capitalist countries is due to the lack of confidence felt by capitalists and workmen alike in the stability and value of the present economic system. Everyone agrees that the Russian workers under the Five Year Plan have put forth a truly astonishing effort ; and it has been repeatedly suggested that it is " against human nature " that this effort should be long sustained. But the history of the world furnishes abundant instances of sustained effort based on a secure and confident faith—and Russian Communism is to those who occupy the key positions, and to a substantial part of those who carry out the lesser tasks, above all a faith rather than a merely intellectual doctrine.

The astonishing progress made by Russian industry under the Five Year Plan, especially in the heavy industries on which the main effort has been so far concentrated, is not denied even by those who are most critical of the Soviet system. According to the official figures, the total output of industry as distinct from agriculture in the territory of the Soviet Union was in 1930 about 80% more than the output of industry in 1913, and bade fair to be double the pre-war output in 1931. In relation to the extremely low levels of production before the beginning of the Five Year Plan the progress was even more striking. Between 1923 and 1929 the output of the mines increased by 154%, that of heavy industry by 480%, and even that of light industry by 259% ; while the daily output per worker went up by 63% between 1924 and 1929. During the same period money wages rose by 70% ; and the standard of living in industry was estimated in 1929 as being about 30% above that of 1913, and substantially more than this above the very low standard of 1924. These increases in production are far in excess of anything that has been accomplished in any other country ; and it is the most significant fact of all that the increase has continued during the past three years, while the rest of the world has been suffering a much diminished volume of industrial production in consequence of the slump.

§ 3. THE SOCIALISATION OF AGRICULTURE

SINCE the original introduction of the Five Year Plan the most dramatic change in the economic organisation of Soviet Russia has been the attempt rapidly to transform agriculture from a system of peasant cultivation to one of large-scale organisation based on collective work. As we have seen, the vast majority of the huge population of Russia is still engaged in agricultural pursuits ; and up to the past two years the great bulk of agricultural production was still carried on under peasant conditions by small cultivators working upon individual holdings. But in 1930 the great movement for the collectivisation of agriculture began ; and according to the latest statistics of the total agricultural output of 1932 no less than three-quarters will be produced under the collective system in one or other of its forms. In the minds of the Communists the outstanding importance of this change lies not simply in the great increase in total agricultural production which it is designed to bring about, but above all in the change in the attitude of the peasant population which is expected to result from large-scale working with the aid of machinery under collective conditions of living as well as production. In order to understand the nature of the task which the Communists set themselves in undertaking this wholesale transformation of the Russian countryside, it is necessary to understand something both of the system which they are endeavouring to replace and of the successive phases of Communist agricultural policy since the Revolution of 1917.

It is universally admitted that the Communist Revolution could never have successfully established the new regime if it had been faced at the outset with the hostility of the main mass of the peasants. For although the Russian peasants, scattered over the vast territory of the Soviet Union, have little cohesion in any constructive sense, and would be unable either to build up a Government for themselves or to dictate—save in a purely negative sense—the

policy which any national Government in Russia should pursue, they would have possessed, if they had been united in their opposition, the power to pull down any Government to which they had been hostile. It was therefore essential for the Communists, after their seizure of power, to keep at any rate a substantial part of the peasant population on their side ; and the necessary means of doing this were ready to their hands. If they gave the peasants the land, they could be sure that the great mass of the peasantry would offer determined opposition to any attempt at counter-revolution which threatened them with the loss of the land, and the reimposition of the old obligations from which they had escaped.

It was, however, contrary to Communist policy and doctrine to give the peasants the land in any absolute sense; for it was a cardinal point of principle among the Communist leaders that the peasant system of proprietorship was bound to be fundamentally conservative and anti-socialist, and the last thing they wanted to do was to entrench the peasants in the absolute ownership of the land as they had become entrenched in France and in certain other European countries. For it was seen that over a large part of Europe the peasants constitute the greatest obstacle to the triumph of Socialism ; and in addition to this the Communists recognised that agricultural production was bound for a long while to play so large a part in Russian life that the manner of carrying it on would necessarily govern in a high degree the economic character of the Soviet system as a whole. Accordingly there was never any question in the minds of the Communists of giving in permanently to the peasants' desire for absolute control of the land under the system of small-scale production and ownership.

The Peasants Take the Land. Nevertheless it was clear that, for the time being at any rate, the peasants had to have the land if the Revolution was not to break down altogether. The solution was found in the immediate nationalisation of the entire land surface of the Soviet Union. The

principle of public ownership was thus declared and held in reserve for application in the future ; but in practice the peasants were allowed not only to retain existing holdings but also to a great extent to seize upon and divide up the estates of the larger landed proprietors. In the period immediately succeeding the Revolution the large estates passed mainly under divided peasant control ; and only a comparatively small area was successfully reserved by the State itself, and made the basis of an experiment in large-scale State farming.

There followed a re-division of the land, still on a basis of peasant cultivation and control. In each village orders were given for the land to be re-divided, so as to take away from those who had too much to provide for their own subsistence, and to parcel out the surplus amongst the poorest peasants and landless labourers so as to give all a sufficient holding according to the very low standards prevailing in Russian village life. This process of redistribution was never carried out completely ; but it was pushed to very considerable lengths in the years immediately following the Revolution. During this period of "War Communism" the problem of food supply both in the towns and for large famine areas in the countryside was very pressing indeed ; and the peasants were highly indisposed to send their grain and other products to the towns, since there were no adequate supplies of manufactured goods available in exchange, and no currency which the peasant could hoard with any feeling of confidence. Accordingly, in order to get supplies of grain and other agricultural products, the Communists were driven to resort to the method of compulsory requisition. All surpluses over and above what the peasants were deemed to need for their own subsistence and for seed were requisitioned by the officials of the Government. Payment was indeed usually made for these supplies in paper money ; but in face of the shortage of industrial goods this paper money had very little value. The peasants strongly resisted the requisitioning of grain ; and there were serious peasant insurrections in various parts of the country

and even a tendency in some areas for the peasants to join forces with " Whites "—for the Civil War was not yet over.

The menace of peasant insurrections was one important factor in compelling the Communists to change their methods and to resort to the " New Economic Policy." At the same time as the resumption of private trade was permitted in the towns the policy of requisitioning grain was abandoned ; and a system of taxation upon the peasants was substituted for it. The peasant was called upon to pay his taxes to the Central and Local Governments—these taxes being later consolidated into a single tax—but thereafter under the " New Economic Policy " he was left free to sell his surplus supplies on the best terms he could get. This was done in order to give the peasant the greatest possible inducement to increase his output ; and it had undoubtedly a considerable effect both in increasing the area under cultivation and in stopping the accumulation of illicit hoards and the wanton destruction of beasts by peasants fearing their seizure by the authorities.

Class-War in the Villages. It seemed for a time as if the Communists had decided to come to terms with the peasant system, and to reconcile themselves to leaving agriculture to be conducted on the basis of small-scale individual farming. As we have seen, their policy in this respect was at the time widely misunderstood abroad ; and it was even loudly criticised in Russia itself by Trotsky and his followers, who considered that the concessions made to the peasants were undermining the very foundations of the Communist system. But the Russian leaders never had any intention that their concessions should be more than temporary ; and they took steps, even while the peasant system was being tolerated to the fullest extent, to prevent the growth of any spread of solidarity among the whole body of small-scale cultivators. This was achieved largely by fostering the spread of class antagonism in village life and by organising the poorer classes of peasants against those who were in a better economic position, and in particular

against those who engaged to any substantial extent in private trade. The *Kulaki* or richer peasants, were especially distinguished from the *Bedniaki* or poorest peasants ; and, while the *Kulak* was tolerated as long as the " New Economic Policy " remained in being, he was deprived of all political privileges and subjected to a great deal of interference by the village Soviets and the local organisations of the Government, and even to a sort of social ostracism organised among the poorer peasants under Communist influence. The *Kulak* was allowed to trade ; but he continued to be regarded as a nuisance, and every possible effort was made to prevent him from securing any ascendency in the life of the village, in order to make easier his complete removal when the time came.

When the Five Year Plan was introduced, the Communist leaders were not yet ready to get rid of the *Kulaki*, or to begin seriously upon the task of socialising agriculture. In the early years of the Plan they had their hands full with the fostering of large-scale industrial development ; and their main concern was to get sufficient supplies of foodstuffs from the villages both to feed the growing urban population and to provide a surplus of exports for the purchase of vital industrial imports. Until the Russians felt assured of the success of the Five Year Plan in industry, and of a sufficiency of agricultural supplies to remove the threat to the life of the towns, the peasant system was allowed to remain in being ; but by 1930 the leaders in Moscow were in a very confident mood. The Five Year Plan in industry had advanced much faster than they had ever expected ; and there had been enough agricultural production to make possible the resumption of exports on a significant scale. The time had come, they thought, for putting into force the ideas which they had cherished from the first of socialising peasant life ; and the experiment was launched with the dramatic ruthlessness which has marked every stage of the Communist advance. The word went forth that over the widest possible field collective methods of production and living were to supersede the individual peasant system ; and

the local authorities were bidden to get ahead at full speed with the change. At the same time the liquidation of the *Kulak* class was speeded up. The *Kulaki* were to be refused admission into the new collective farms into which the existing village holdings were to be aggregated. Their land and stock were to be confiscated ; and they were driven out of the villages wholesale, and either removed to distant areas, in Siberia, for example, or sent to work as labourers in the timber camps, or on other forms of public enterprise.

State and Collective Farms. It is necessary at this point to make the distinction between State farms and collective farms under the new Russian system. As we have seen, when the peasants got possession of the greater part of the land after the Revolution, a small part of the old great estates was retained under State control and worked thereafter by means of large-scale State farming. These large State farms were used to a considerable extent for the purpose of demonstrating to the peasants by force of example the productive advantages to be derived from the use of machinery and large-scale methods of "industrialised" cultivation. But, apart from the land seized by the peasants and that retained by the State, there were in Russia huge areas of altogether uncultivated land, out of which year by year the State took large tracts into cultivation under the auspices of the Commissariat of Agriculture. These State "grain factories," as they were called, were given preference in the supply of agricultural machinery, and were worked under a more mechanised system of farming than exists anywhere else in the world ; and their area was gradually extended season by season until they came to provide an important part of the surplus of grain available for export in the hands of the State. The State farms, however, continued to account for only a very small fraction of total agricultural production ; for the greater part of the land remained in the hands of the peasants under the individual system. Accordingly, the problem was—side by side with the gradual development of State farms on previously uncultivated

areas—to provide for the socialisation of farming methods on the far vaster tracts already in peasant occupation.

The instrument employed for this purpose was the "collective farm," which has in effect several different forms or stages. At the most rudimentary stage the land of the peasants who are organised in a collective farm is pooled for purposes of cultivation, which is thereafter carried on under the collective system ; but each peasant is left in private ownership and control of his own beasts, and of other forms of auxiliary production. In a more developed form of collective farm, the stock as well as the land is socialised ; and the entire business of production is then carried on by and for the benefit of the group as a whole. This is the form of collective farm often known as the "Artel." In a third and most developed type of collective farm, the ways of living as well as of production are socialised ; and the whole group of peasants lives as well as works in common in new buildings erected as part of the scheme of collective organisation. There are in practice, of course, all sorts of intermediate varieties of collective organisation ; but for the most part the new collective farms of Soviet Russia at present approximate to the second of these three types.

The sudden introduction of collective farming over a large part of the area of the Soviet Union startled the world more than any previous development of Communist policy. It was widely held abroad that this attempt forcibly to transform the lives of tens of millions of peasant cultivators was bound to produce a revolution which would result in the overthrow of the Communist regime. It was prophesied that the peasants would go on strike and refuse to produce under the new system, that Soviet agents who attempted to introduce it into the villages would be slaughtered, and that famine would speedily compel Russia to revert to a recognition of the peasant economy. But in fact this did not happen. The campaign against the *Kulaki* did indeed result in a great deal of slaughtering of beasts by peasants expecting the confiscation of their property ; and this has made the problem of meat supply in Soviet Russia very

difficult. But the power of the peasants to resist had been effectively broken by the policy previously adopted in the villages ; and there was nowhere any substantial peasant revolt against socialisation. Indeed, it seems to have been popular on the whole with the younger members of the peasant classes who had come under the influence of the Soviet's educational methods, though it was undoubtedly very unpopular with many of the older peasants.

The Old Russian Agricultural System. It must, moreover, be realised that foreign opinion is very apt to misunderstand the real character of the change which the collectivisation of Russian agriculture involves, because it tends to think of Russian peasant farming as if it were like small-scale farming in such countries as Great Britain or America. It was, however, in fact very different. In the first place the Russian peasant, under the old system, did not live on his holding. He lived in the village, from which each peasant went out to work his holding upon the neighbouring land. This holding, even if it was held in permanent possession by the individual peasant, was very often divided into a number of patches of land in different parts of the village area—as used to be the case in Great Britain before the enclosure movement of the eighteenth century. In some places the land was even periodically re-divided, and there were no permanent holdings. Russian agriculture had indeed never escaped at all completely from mediæval methods of tillage, which involved a considerable degree of communal organisation. The change from the peasant system to collectivisation, while it was very great, was therefore far less than a similar change would be in Great Britain or America or Canada, or even in France or Germany, or any of the more advanced countries of Europe. The peasants after collectivisation continued to live as before in the village, although to the existing hovels there were commonly added new buildings belonging to the collective farm as a whole. They continued to go out from the village to work ; but they were no longer working on

isolated strips of their own, but on land operated in common by the group. The change-over, therefore, from the old system to the new was easier in those parts of Russia in which previous agricultural methods had been most primitive and had retained the largest amount of communal organisation than in the more developed agricultural areas, in which standards of cultivation were higher and more individualised, and the *Kulaki* formed a larger element in the peasant population. But, on the other hand, these more developed areas offered in the expropriation of the *Kulaki* the largest material inducement to the poorer peasants to adopt the collective system.

Accordingly, collectivisation went ahead by leaps and bounds, and met with surprisingly little resistance. But the degree of resistance was very different in different areas ; and the local Communist leaders in their enthusiasm overshot the pace at which it was possible to bring the new organisation effectively into being without severe dislocation of the productive life of the villages. Accordingly, in the spring of 1931, it became necessary to slow down the pace of collectivisation in order to afford a breathing space for consolidating the area within which it had already been applied. But it is clear that this halting of the movement was never meant to be more than temporary. For it is the full intention of the Russians both to bring practically the whole agricultural area of the Soviet Union under either State or collective farming and to make the collective farms adopt as far and as fast as possible the large-scale mechanised methods of production characteristic of the huge state " Grain Factories." How fast this can be done depends largely on the rapidity with which the output of agricultural machinery can be increased ; and the Russians are now busily expanding their great new tractor-building workshops at Stalingrad and in the Ukraine in order to equip the new collective farms as rapidly as possible with machines designed both to increase agricultural production and to educate the peasants towards the adoption of an industrialist attitude to life.

There can be no doubt that in the long run the collectivisation of Russian agriculture is likely to involve a great diminution in the quantity of labour required for production on the existing cultivated areas. According to the standards of the rest of the world, or to those which already exist on the State farms in Russia itself, the new collective farms tend to be heavily over-staffed ; for they include practically the whole body of peasants previously engaged in agriculture under an exceedingly inefficient and labour-wasting system. For the moment the Communists are allowing this over-staffing to continue ; but it is their intention to weed out the surplus labour and transport it either to the expanding urban industries or to new land which is available in unlimited quantities for the plough. By this means the area of State as against collective farming is likely to be increased considerably during the next few years.

The Future of Russian Agriculture. The agricultural production of Russia has naturally increased so far very much less than industrial production since the beginning of the new planned economy ; for the main effort of the Communists has been concentrated until quite recently upon industry, and the task of reorganising agriculture on industrialised lines is far vaster and bound to take longer than the industrial part of the Plan. But in the light of what has been done already there seems no reason to doubt that the Russians will succeed in bringing about a tremendous expansion in their production of foodstuffs. Doubtless the greater part of this increase will go into the raising of the standard of living at home, particularly when they begin to direct as much attention to the increased production of meat, vegetables and other food products as to the mass output of grain. But, although Russia will consume most of her expanding agricultural yield at home, she is bound to become again also an important factor in the world's grain trade. She was before the war the granary of Europe ; and her permanent disappearance from the European grain market is not to be expected. For she is bound to

need for a long time to come considerable quantities of industrial imports ; and she has no prospect as yet of becoming an exporter of manufactured goods. Her chief exports are bound for some time ahead to be oil, timber—of which she has almost inexhaustible supplies in her vast forest areas—and grain. It is true that her prospects as a grain exporter are highly unfavourable in terms of price ; for the disappearance of Russian exports from the market since 1914 has been one of the main causes of the vast expansion of wheat production in other areas, notably in Canada and the Argentine, and in face of the existing surpluses of wheat Russian grain can only be placed on the world market at a very low price. But this, while it restricts the quantity of manufactured imports which Russia can get in exchange for her grain, so far from deterring her from production—as it would deter the individual producers in other countries—serves positively to stimulate her leaders to greater efforts, as they must supply more grain in order to buy the manufactures which they need. This is the true explanation of so-called Russian "dumping," which is as unavoidable for the Russians as it is inconvenient for the grain producers of the other leading countries.

The low price of grain does indeed induce the Russians to do all they can to increase the export of other goods, and particularly of timber products and of oil. Of oil their resources, still largely untapped, are by far the greatest in the world ; and the oil industry is being developed very rapidly indeed both for export and as a fuel for the expansion of domestic production. In the same way the Russians are seeking greatly to expand their export of timber, with the result that the aggrieved timber producers of Finland and Sweden and other areas lose no opportunity of dilating upon the horrors of the Russian timber camps in an endeavour to organise a boycott of Russian supplies. But such a boycott is most unlikely to succeed. For the Russians must sell in order to buy ; and they will therefore be prepared to sell their timber abroad for what it will fetch, and stories of atrocities in the timber camps are not likely

for long to induce the rest of the world to forgo cheap supplies in the interests of Swedish and Finnish exporters.

§ 4. THE TRANSPORT PROBLEM

THE SUCCESS of the Five Year Plan is, in the light of what has been said in the two previous sections, undoubted as far as both agriculture and productive industry are concerned. This does not mean that the success is unqualified, or that it comes up to the most sanguine expectations of the promoters of the Plan. But it is thoroughly remarkable and indeed astonishing to the rest of the world ; for the Russians have usually been credited with a "human nature" singularly averse to the discipline of hard and systematic labour, and with a lack of organising capacity which was commonly regarded as likely to bring the Five Year Plan to shipwreck in its early stages. It is true that, according to Western standards, Russian labour is probably still largely inefficient and possesses a low productive capacity, and that the existing achievements of the Five Year Plan could not have been accomplished without the aid of a large band of foreign experts—engineers, electricians, business organisers, and the like. Americans have largely come in to fill the place which was taken by Germans in the technical development of Russian industrialism before the war ; and it is too early as yet to say how far the native Russians are becoming capable of carrying on by themselves without this foreign help.

But it has to be remembered that among Russian Communists are included a considerable number of men who have had experience of large-scale industry abroad, especially in the United States, and have returned to the country since the Revolution, and that intensive efforts are now being made to train Russian specialists in the new Soviet educational institutions. This training is indeed at present being conducted in so terrific a hurry that it is bound to lack thoroughness ; but as the supply of technicians

of a sort becomes more adequate the Russians will become freer to devote their attention to improving the quality and extending the duration of periods of training, and the results secured up to the present seem to show that the Russian character under the influence of strong Communist conviction is capable of ready adaptation to the new system. This applies not only to technicians and administrators, but also to skilled manual workers. The "shock brigades" of Communists who have been everywhere in the forefront in the tuning up of industry under the Five Year Plan are the pioneers of a new skill and industrial adaptability, acquired less for purposes of personal gain than as the equipment for communal service. It is often suggested that the enthusiasm behind this idea of service will speedily evaporate, and the old Russian character reassert itself; but is there really any reason for believing that this will happen? The Germans of the latter part of the nineteenth century possessed a very different national character from the Germans of half a century before, and so did the Danes in an equally marked degree. The Russians are no doubt attempting to transform national character more rapidly and drastically than it has ever been transformed before; but may not their view—preached a century ago by Robert Owen in England—that national character depends on environment and is almost infinitely adaptable to changes in environment be right? The evidence of America, as well as Germany and Denmark, seems at any rate to lend strong support to this view.

But, while the human achievements of Russia under the Five Year Plan have been remarkable beyond all precedent, and there has been a wonderful recovery and development of both industrial and agricultural production, there still remains one very weak link in the Russian economic system. The Russian transport industry is still quite inadequate to deliver successfully the greatly increasing quantity of goods which it is now called upon to handle as the Five Year Plan proceeds. Russia has always been a

country of very backward development in the matter of railways. A large part of her area is altogether out of reach of her railway system, which is quite inadequately equipped with branch lines to feed the great main-line railways. Water transport does something to supplement transport by rail ; but over a large part of the country this too is not available, or not usable all the year round. Moreover the Communists inherited a transport system which had been completely demoralised by the over-strain put upon it during the war and by the military requirements and the destruction of the subsequent civil war. Railway material had been largely imported into Russia ; and the supplies were stopped. It was impossible to renew rails or to bring damaged locomotives and rolling stock back into effective service. The efficiency of the railways continued to decrease long after the Communists had begun their constructive work ; and the reorganisation of the railway system still lags far behind the necessities of the new productive organisation. For the building up of an efficient railway system is an appallingly huge and difficult task. There is need for the reconstruction and the keeping in repair of the existing lines ; but there is also a clamant demand for additional lines to open up new areas which are being rapidly industrialised. The famous " Turksib " is the outstanding example of this attempt to create fresh railway facilities in rapidly growing industrial areas. The Five Year Plan made provision for a heavy expenditure on railway renewals and expansion ; but it has already been realised that this provision was inadequate in relation to the expansion in the volume of goods requiring to be carried over the railway system. Accordingly the second Five Year Plan includes an attempt seriously to tackle the transport problem, and to equip Russia with a railway system adequate to the needs of her rapidly growing industrialisation. She has solved already the problem of the supply of steel rails ; but that of rolling stock is far harder, and she is only at the beginning even now of developing road transport on any considerable scale. Once the supply

of tractors and agricultural machinery has begun to catch up with the vast demand made upon it by the collectivisation of agriculture, the expansion of transport facilities will be the main task of the Russian engineering and kindred trades.

§ 5. CONCLUSIONS

IN PASSING judgment on the Russian experiment, opinion in other countries is inevitably influenced in a very high degree by political considerations; and these affect not only judgments upon ascertained facts but the ascertainment and statement of the facts themselves. Despite the increase in the number of foreigners who have visited Russia during the past few years and the number of books written about Russia by these visitors, it is still very difficult to get at the real facts of the Soviet system. This is not so much because of any deliberate concealment on the part of the Russian authorities as because the unfamiliarity and newness of the Russian system make it extraordinarily hard for the foreign observer to know what to look for or to understand what he sees. He comes to Russia with the very different economic system of his own country in mind; and he looks for things which he can compare with what he knows, and is apt to apply in the comparison standards derived from the systems with which he is already familiar. Or in the alternative he goes to Russia in strong reaction against the economic system of his own country and prepared to find every difference a difference for the better. But, even so, it is hard for him, in the space of a brief visit, to understand the underlying structure of the Russian economic machine, or validly to appreciate the working of its several parts without this understanding. Statistics are proverbially capable of being used to prove almost anything, at any rate to the satisfaction of those who do not understand the objective phenomena on which the statistics are based. Accordingly writers about Russia in other

countries find no difficulty as a rule in interpreting what they see in Russia in accordance with their previous convictions and standards, and in finding more or less what they expect to find.

The difficulty of getting at the facts is greatly increased by the presence in most countries of a body of Russian *émigrés* animated by a passionate hatred of the Soviet system, and desirous above all of discrediting it in the eyes of the world. A large part of the information in the press about Russia comes either directly or indirectly from these *émigrés*, and presents a thoroughly distorted vision of what is going on. On the other hand, statements which come from Communist sources are not readily received either by the newspapers or by the great mass of opinion that is politically hostile to Communism. Statements and counter-statements therefore fly about to the bewilderment of those who are eager above all else to get at the truth ; and even the reading of the many books about Russia written from many different points of view is apt rather to increase bewilderment than to bring real illumination with it.

Nevertheless, amid all the conflicting statements of fact, there seems to be a growing measure of agreement that for good or ill the new Russian system has consolidated its authority and is in no danger of any real breakdown, though it may encounter owing to famine or to war or economic blockade temporary setbacks of a sufficiently serious kind. But whether this stabilisation of Communism in Russia is to be regarded as a good or a bad thing is a matter on which clearly no agreement can be expected ; for to those who are seeking a reconstruction of Capitalism in the rest of the world the success of an utterly different system of economic organisation is most unlikely to be welcome, certain as it is to intensify the criticism of capitalist institutions in capitalist countries, and to suggest to a growing number of people that not a reconstruction of Capitalism but its supersession is the true line of advance for a world anxious to find some way of escape from its present economic plight. Capitalist opinion may recognise the necessity

of living on terms with a Russian Communism that has clearly come to stay ; but it cannot be expected to regard Russian Communism as anything other than a menace to the institutions which it wishes to preserve. For, as we have seen, the Russians have certainly not abandoned the idea that their Revolution is merely an instalment of the world revolution destined in due course to extend to all countries from the highly industrialised States of the Western world to the vast peasant civilisations of India and China.

Socialist Attitudes to Russian Communism. On the other hand, among those who are hostile to capitalist institutions there is no unanimity of welcome to the Russian system. For Socialism has grown up in the western countries under conditions vastly different from those of Czarist Russia. It has been able almost everywhere in the western world to express itself openly in the creation of political parties, and to secure minority representation in the various national Parliaments. It has been persecuted less and less in recent times ; and in several countries Socialist Governments have actually held office, if not real political power. Conducting its agitation under these conditions, western Socialism has become largely a reformist movement ; for its seeking of political representation has involved the necessity of appeals to the electorate on the basis of offering immediate advantages. The prospect of revolution in most western countries has never been immediate—or at all events was not immediate when the various western Socialist movements grew up and acquired their distinctive character. Moreover, in many of the western countries Socialism had grown up on the basis of a close alliance with Trade Unionism, which has been far more preoccupied with such immediate questions as wages, hours of labour, the provision for the unemployed, and other measures of social and industrial reform than with the long-run reorganisation of society on a Socialist basis. Thus, while Socialism has remained as the ideal, the attainment of Socialism has tended in practice to be subordinated

by Socialist political parties to the immediate endeavour to achieve social reforms within the structure of the existing system ; and the coming of Socialism itself has been envisaged, not as a sudden substitution of one economic system for another such as happened in Russia after 1917, but rather as the extension of the movement for social reform, passing into its constructive phase through gradual nationalisation of one industry or service after another. But this conception of Socialism is anathema to the Communists, who, following Marx, think in terms of an essentially sudden and revolutionary transformation of the economic and political system. They do not believe that the bourgeois State as it now exists is capable of gradual capture by the Socialists and of use therefore as an instrument for the administration of a Socialist society. They hold that it is far too deeply permeated with capitalist ideas to be a suitable instrument for the execution of a Socialist policy. They believe, as Marx believed, that the bourgeois State must be, not captured, but broken and displaced in favour of a new proletarian State to be created on its ruins as a conscious act of revolution. It is their firm conviction that the attempt to use the existing State as an instrument of constructive Socialism is bound to result, not in Socialism, but in a diversion of the parties which adopt this policy from their Socialist aims to a mere reformism which will keep them confined securely within the ideology and structure of Capitalism. And they point to the actual record of Socialist Governments in office, and to the policy of collaboration with capitalist Governments adopted by the Socialists of Germany since 1918, as fully bearing out this gloomy anticipation.

The Socialists of the western countries, for their part, look with mixed feelings on the success of Russian Communism. For the most part they have long been advocates and defenders of the democratic parliamentary system, holding that the instrument of parliamentary democracy can be used for the achievement of Socialism as soon as the mass of men can be converted by constitutional propaganda to the

support of a Socialist Government. Parliamentary democracy is in their bones, part of the inherited tradition of their countries. They have not been, as the Russians were, excluded from the sense of any share in the conduct of government or in the influencing of legislation ; and their successes in the promotion of social reform and in the raising of the working-class standard of life have been considerable enough to encourage them in the belief that an instrument so beneficial for these limited purposes must be capable of a more ambitious use. They are menaced in their own countries by groups which have gone over to Communism in violent reaction against the limitations of reformist policy ; and they are apt to see in the success of Communism in Russia the danger of further strengthening in their own countries of the forces which threaten the disruption of the parties they have spent their lives in building up. On the other hand, they are believers in Socialism ; and they are therefore profoundly attracted to the one large-scale experiment in Socialist organisation the world has yet seen. Torn between these two points of view, they come down some on one side and some on the other, or try as long as they can to avoid coming down decisively on either side. The British Socialists, more isolated from contact with Russia than the continental parties, and with far less Communism at home to contend with, have so far kept the most open minds, and been least inclined to develop anti-communist hysteria. The Germans, on the other hand, faced with great internal difficulties of their own, have become in many cases violently anti-communist. It has seemed to the most influential leaders of German Social Democracy in the recent troubled years that their first duty was to preserve the new German Republic against the monarchist reaction, and to avert the danger of the dissolution of Germany in civil war and complete economic and political collapse. This has caused them to ally themselves with the middle parties representing the German bourgeoisie, and to subordinate their Socialist aims to immediate political exigencies, even to the extent of acquiescing

in measures of which they have strongly disapproved. The pursuit of this policy has inevitably involved a great strengthening of the forces of German Communism ; for German Social Democracy, committed to the defence of the Republic and to the policy of carrying out the terms of the Versailles Treaty, has been unable effectively to defend the standard of living of the German workers, which has had to be pressed down in order to avoid German default. German Socialism of the orthodox type has thus found itself in the unenviable position of being between two strong fires—of Communism on the one hand and of Hitlerism on the other ; and in these circumstances anti-communist feeling among German Socialists has been very strong, and the instinctive sympathy felt with the attempt to establish a Socialist regime in Russia has been submerged in the fears aroused by German Communist policy.

In these circumstances world Socialism has been divided and hesitant in its attitude towards Russia. Influenced by the opinion of *émigré* Russian Socialists of the Social Revolutionary and Menshevik parties, the Socialists of western Europe were disposed for a long time to believe in the impending collapse of the Communist regime. They have, indeed, been compelled to revise their ideas on this subject, and to recognise that Socialism in Russia is among the most stable, if not the most stable, of European political systems. But the effects of this realisation that the Russian system has come to stay have not yet had time to make their influence felt upon the policies and attitudes of the European Socialist parties, as they are bound to do in the long run. For either European Social Democracy will have to amend its outlook and programme so as to take far greater account of the position of Russia and the lessons of the Russian experiment, or there will certainly ensue in the European countries a growth of Communism leading to a fatal division among the Socialist forces. Communism in western Europe shows no signs at present of becoming a strong enough force to seize power and to instal a Communist system ; but without this it may become strong enough to retard indefinitely or to

prevent altogether the conquest of political power by the Socialist parties.

It therefore becomes necessary for the Socialist, as well as the capitalist, world of western Europe and America to reconsider its attitude in the light of the apparently secure establishment of Communism over a large part of the earth's surface, and one destined speedily to become vastly more important in an economic sense. For Socialists the problem is that of devising policies capable of bringing about the transformation of society from a capitalist to a Socialist basis far more rapidly than their past policies have envisaged ; for it is clear that within the next few years Capitalism, over a large part of the world, will be either reconstructed on new foundations or superseded by some alternative system—if indeed the destiny of capitalist countries is not to go down in chaos without either of these things being achieved. In the next chapter we shall be examining the more recent developments of Socialist policy under the influence of a keener sense of the immediacy of the task of replacing Capitalism, and in view of the lessons to be learnt from what has happened in Russia. But at this point we may confine ourselves to considering the reaction of the Russian experiment, not on Socialist ideas, but on capitalist practice and attitude—in other words on the policies which are now being put forward as the basis for a reconstructed world capitalist system.

The Moral of Organised Planning. The outstanding feature of the Russian economic system, as it appears to the capitalist world, is organised planning—the direction from a single centre of the whole economic life of the nation, accomplished by a strongly organised central Government directly in possession of the great bulk of the nation's productive resources, and able by virtue of this control to direct the accumulation of capital at will towards this or that form of productive enterprise. In capitalist countries, the degree of development attained to by each industry or service is the result not of organised central planning

but of a spontaneous growth which is supposed to arise out of the independent movements of consumers' demand. Industries rise and fall, and capital is lost or fortunes are made, according to the ebb and flow of consumers' demand for particular types of products, including of course the demand for exports as well as in the home market. It used to be the faith of the upholders of Capitalism that this spontaneous development of industrial enterprise would result automatically in a balanced economic system and in the production of the maximum amount of wealth and satisfaction. But this view depended on the assumption that there would be no limit to the demand for goods save the power to produce them, and that, subject to minor frictions in the working of the economic machine, the available productive resources would normally be fully employed in generating at the same time wealth and incomes. But the experience of the post-war world has shown that these automatic adjustments work, if at all, only with a degree of friction which involves large-scale unemployment and brings with it a serious dislocation of the financial as well as the industrial machine. Men's minds in capitalist countries therefore turn yearningly towards the idea of systematic economic planning, which in its national form further fits in well with the growing tendency towards economic nationalism. For a tariff may be plausibly regarded as one of the instruments for the execution of a national plan. A tariff or any similar protective measure can obviously be used to stimulate one industry and retard another, and can therefore operate as a means of influencing the flow of capital and the direction of employment. What more natural than to think of deliberate industrial planning as the logical sequel and correlative to a policy of commercial protection?

Can Capitalism Have a Plan? But, when capitalist nations attempt to plan their economic life, it is speedily realised that nothing like planning in the Russian sense is possible under capitalist conditions. For, whereas in Russia

the capital belongs to the State, in other countries it is the property of private persons who are free to invest it where they choose or, as now happens to an alarming extent, not to invest it at all. Various projects have been put forward for controlling the direction of investment through the offer of inducements to the investor, such as the guarantee of interest or dividends by the State, or for the formation of some sort of Capital Investment Board, empowered to borrow from the public with a view to reinvestment in the industries which the State wishes to foster or to re-equip. But it is exceedingly difficult, though it may not be impossible, to establish any effective control over the movements of investment and production while both existing industries and new capital remain under private ownership; and, though some form of national planning may be possible under these conditions, it can obviously bear only the most distant and superficial resemblance to economic planning in the Russian sense. Moreover, there arises, when it is projected, the question whether a Capitalism so controlled by the State as to render possible the working out of a systematic national plan will be able to retain the virtues of the capitalist system, or will rather tend to make the worst of both worlds—to undermine the incentives and the initiative of private investors and private captains of industry, without setting up in their place the new driving force of Socialism. For Capitalism as a system depends fundamentally on two forces—the free play of consumers' demand on the one hand, and the initiative of the capitalist producer on the other. If these are undermined, Capitalism as a system can no longer be made to work; and it remains to be seen whether a controlled Capitalism based on national planning will be able to allow either of these forces sufficient freedom of action. The same difficulty to a great extent confronts the policy of gradualist Socialism; for the attempt to infuse certain elements of socialistic control into Capitalism, without replacing it completely, carries with it all the dangers of setting up an inherently self-contradictory system based on an unworkable compromise.

CHAPTER XII: ALTERNATIVES TO CAPITALISM

§ 1. CAPITALISM, SOCIALISM AND CO-OPERATION

As we saw at the beginning of the last chapter, Capitalism is by no means the only form of economic organisation at present existing in the world, even outside Russia, or even apart from the fact that a very large section of the world's population is still living in India and China and other undeveloped countries under pre-capitalist conditions of small-scale peasant cultivation, and that in Africa and elsewhere there are still millions existing in an even more primitive fashion. In the developed countries themselves Capitalism is subject to an increasing challenge from rival forms of economic organisation, such as public ownership of one sort or another and the consumers' Co-operative movement. Nor is Capitalism itself always and everywhere the same even in its salient characteristics. In the most developed countries, such as Great Britain, Germany and the United States, the small-scale producer has by no means been crushed out by the advance of mass production and

large-scale organisation. He continues to hold his own, or at any rate to give way but slowly, in a great number of trades to which the economy of mass production cannot be, or at all events has not yet been, successfully applied. The number of small businesses, according to the successive censuses of the leading countries, even tends to increase ; and while a good many of these smaller businesses are in effect little more than sub-contracting agencies or subsidiaries of larger concerns, the small-scale producer, and still more the small-scale trader, still occupies an important part in the economy even of the most advanced countries. Retail trade is of course the field in which small-scale production still most obviously survives. There has been in recent years a great growth of chain stores and multiple shops, as well as of Co-operative Societies ; and the small-scale shopkeeper does a much smaller proportion of the total trade in all the advanced countries than he did a generation ago. But absolutely the amount of trade carried on under small-scale conditions has increased, though it has not kept pace with the advance of production. Of late there has been, especially in America, some attempt on the part of the small-scale traders to maintain their position in the face of the advance of the chain stores and multiple shops by the creation of voluntary agencies for the purchase and even the manufacture of supplies. Some of these attempts have resulted in the creation of federal bodies of small traders closely analogous to producers' Co-operative organisations; but in other cases the small shops which have linked up into a voluntary chain store movement have passed virtually under the control of large-scale wholesalers who undertake the supply of goods to all the members of the chain. In other fields there has been very little attempt at collaboration among the small-scale traders, except for the purposes of trade defence. They have their collective agencies for the recovery of debts and for pressing their point of view upon the public authorities through such bodies as Chambers of Trade or sectional associations of retailers in particular branches of distribution. But they

have shown as a rule very little cohesion or capacity to act together; for small-scale trade is essentially competitive, and among the small-scale traders the struggle to survive is usually intense. There is a constant stream of bankruptcies and failures, which does not, however, deter a constant stream of new entrants; for small-scale shopkeeping remains for one considerable stratum of the population of the more developed countries the easiest way of becoming one's own master.

Many of the small-scale shopkeepers, however, starting almost without capital, are from the first largely under the thumb of the wholesalers from whom they derive their supplies upon credit. This dependence is greatest in the drink trades with their system of tied public houses financed by one or other of the large brewing concerns; but it also pervades a large part of the area of small-scale shopkeeping, and goes far to destroy the real independence of the small master in this field of business.

The Survival of Small-scale Industry. Nor are the small-scale producers, who still hold their own in a number of branches of production, commonly in much better case. They have even less capacity for organisation than the small-scale shopkeepers; and unless they are producing a highly specialised type of consumers' goods for which they can command a market of their own they depend in the main for orders upon the controllers of large-scale business. They have little initiative or influence upon industrial or commercial policy. The utmost they can do is to make a living for themselves in this or that nook or cranny of the business world which large-scale Capitalism has passed by. The chief exception to this generalisation is found in new and rapidly developing trades, for in these there are still often opportunities for the small man not only to hold his own but to make high profits and mount the economic ladder towards a more assured independence. The garage proprietor, basing his prosperity on the enormous increase in the use of automobiles in recent years,

is the outstanding example of this type of success ; but even in this case many of the small proprietors have to finance their businesses with borrowed money, and are in the hands of the large motor firms as whose dealers and agents they act.

Therefore, although in developed countries small-scale production is by no means completely ousted by the growth of large-scale enterprise, it is of relatively little importance in influencing the character of the productive and financial system as a whole. There is indeed some tendency for it to become more important at the present time ; for the rapid evolution of industrial technique combined with the rise in the standard of living during the past twenty years has caused the multiplication of new trades catering for developing forms of demand, and such trades are the happy hunting-ground of the small independent producer. But as these trades become more standardised and reach the stage at which mass methods can be more readily applied to them, the small man's position is bound to be increasingly challenged by large concerns in both producing and selling operations ; and the small-scale producer or trader, if he wishes to hold his own, still has to be constantly seeking fresh fields for his activity. Nearly a hundred years ago, in the *Communist Manifesto*, Karl Marx and Friedrich Engels drew a sharp contrast between modern large-scale Capitalism and the small-scale production carried on by what they called the *petite bourgeoisie*. Already in 1848 they regarded the *petite bourgeoisie* as a dying force, impotent in face of the growth of large-scale Capitalism and the class conflicts engendered by the Industrial Revolution. The *petite bourgeoisie*, according to Marx and Engels, was even then essentially a reactionary group hostile to the development of the new powers of production and seeking constantly to prevent change. It would ally itself sometimes with the rising power of the working classes in opposition to the new capitalism ; but if its working-class allies attempted any fundamental revolt, it would at once change sides and join forces with large-scale Capitalism for their suppression. It

was seen in action in the European revolutions of 1848, first on the side of revolution, and then in opposition to the attempt to give revolution, in Paris for example, a Socialist turn. It has been seen at work often again since then—in the movement for anti-trust legislation in the United States, in the non-Socialist parties of the "Radical Left" in France, and in the councils of the Liberal party in Great Britain. But always, as Marx and Engels said, it has been an essentially unconstructive force, seeking to stop things from happening but possessing no positive policy of its own beyond the desire to conserve the position of the small-scale producer against both Socialism and Capitalism in the modern sense.

The New *Petite Bourgeoisie*. Marx and Engels, writing at a time when men's minds were filled with the wonders of the Industrial Revolution and the new factory system, were inclined to predict the speedy disappearance of the small producer and trader before the onset of the new forces. They suggested that he would be crushed out between giant Capitalism and the working class movement, and that most of the members of the *petite bourgeoisie* would find themselves driven down in due course into the ranks of the working classes. Actually, as we have seen, this has not happened. Small-scale production and small-scale trade have survived and are likely to survive as long as Capitalism itself remains in being. But, although Marx and Engels were wrong in predicting their disappearance, they were essentially right in regarding them as unconstructive and negligible as a creative force. What they did not see was that side by side with the development of large-scale Capitalism there was growing up a new intermediate class consisting not of the small-scale producers and shopkeepers but of the salaried employees of large-scale business and of the professions, which increased rapidly in numbers and importance as the standard of life rose. This new middle-class, dependent upon the development of modern machine production, is not, like the *petite bourgeoisie* of Marx's day, a

spent force. It has behind it a creative power of its own ; for it largely organises the productive work of the modern world. It is a power to be reckoned with in all policies appropriate to the twentieth century ; and it is undoubtedly destined to play an important part either in the preservation or reconstruction of Capitalism or in its supersession by an alternative economic system.

The absence of this class in Russia on a scale considerable enough to exert any real influence on the development of affairs was one of the most important factors in giving the Communist Revolution its peculiar character. Russian industry was carried on largely with the aid of foreign experts and business men. The professional classes were few in numbers, weak and almost unorganised. There was indeed under the old regime a very large class of State officials who formed an intermediate group between the governing and the working classes ; but these officials were tied closely as a class to the institutions of the old regime, both by virtue of their office and as a matter of the deliberate policy of Czardom. They were essentially the allies of the old order ; and when the revolution came they were broken and not in a position to play an effective part in the work of reconstruction.

Russia therefore came very near to having to build up her new State out of purely proletarian elements reinforced only by the revolutionary renegades of other social classes. These renegades assumed the leadership of the Communist movement ; but they had to work with instruments drawn mainly from the Russian proletariat. Such a situation could not possibly arise in any of the more developed industrial countries ; for there this intermediate class of salaried technicians and administrators and of professional men is far too numerous and influential to be lightly passed over—nor can it be reckoned as being by any means solidly on the side of Capitalism. It is doubtless ranged with Capitalism now, for it wields its authority as the delegate of whatever class holds the ultimate control of economic and political policy. But it is fully capable of

changing sides; and it is even clear that in the event of a fundamental conflict between Capitalism and Socialism it would already be divided sharply in its allegiance. If Socialism is to come into existence in the more developed industrial countries, it will need to carry with it the support of a substantial element in this intermediate class. It could not possibly be built up in face of this class's solid opposition, or without some constructive aid from it.

But for the moment this intermediate class, as far as it is directly engaged in industry or commerce, appears mainly as the representative of large-scale Capitalism in the actual carrying on of business operations. It has acquired of late years a growing self-consciousness of its own, a developing sense of its importance in the conduct of industry, and a marked tendency towards the creation of a professional spirit based on professional associations of many different kinds. It is often, like other organised occupations, narrow and sectional in its outlook; and in some fields, as in the medical profession, it has taken to heart and applied the lessons of Trade Unionism learnt from the manual workers even more effectively than the manual workers themselves. But few professions are yet as closely knit as the manual trades for purposes of mutual defence; and many of the more important technical groups in the working of modern industry are still only at an early stage in the evolution of a professional consciousness and a professional conscience. Their power has grown, is growing, and will continue to grow; and it will grow the more rapidly because modern joint stock business, with its widely diffused ownership, is becoming more and more impersonal and more and more financial in its outlook. The shareholder, as we have seen, plays no constructive part in the conduct of industry or the improvement of business organisation. He is purely passive, the mere recipient of dividends; and even the capitalist heads of modern great businesses tend to be far more financiers than industrialists, so that the positive carrying on of industry as a technical operation is left more and more in

the hands of the salaried classes who become accordingly more and more conscious of their power and of the functionlessness of the Capitalism which they at present serve. This facilitates their conversion to faith in a different social order, and exerts, in western countries, an influence on Socialist policy which the Russians, basing their views on their very different national experience, find it extraordinarily hard to understand. The failure of the Russian Communists to interpret aright the currents of western Socialism arises largely from a failure on their part to appreciate the power and significance of this intermediate social group.

The authority of the salaried technicians and administrators of industry is most fully recognised in those branches of production and service which are already under some form of popular control. In industries such as the Post Office which are directly administered by the State, the political Minister at the head of the Department usually knows far too little about the business to exercise effective control, and the real power is in the hands of the civil servants who are nominally under his authority. This situation is even more plain where the administration of a publicly controlled service is delegated to a public utility corporation or some similar body, such as the British Broadcasting Corporation or the Central Electricity Board in Great Britain ; for these institutions are governed in theory as well as in fact by their salaried heads, without even the nominal responsibility of a political Minister for their day to day conduct. Nor is the position very different in such great joint stock concerns such as the railways or the banks ; for in these and many other cases the salaried heads have come to occupy a position and to develop an attitude of mind closely akin in many respects to that of salaried State servants. These concerns, unlike the businesses operated under State ownership, are, of course, still working for private profit ; but it is true to say that the attitude of mind of their salaried heads comes to be governed fully as much by the conception of the interest of the

business as by the desire to provide dividends for those who hold its shares.

The Growth of Public Enterprise. We have seen that there exist already in modern communities a number of industries and services owned and administered by public bodies either directly by the State or by municipalities, or through some sort of public utility corporation appointed by the State. But these publicly administered services, while they would fit in with the structure of a Socialist community, cannot be taken as they stand as working models of Socialism ; for any institutions carried on under the auspices of the State are bound to take their complexion from that of the State which is responsible for them. In a capitalist State, publicly owned services will acquire many of the characteristics of Capitalism ; and it is significant that some of the most developed examples of what is called " Municipal Socialism " in Great Britain are found in the cities most thoroughly dominated by Conservatism—in Birmingham, for example. It is also significant that the most important extensions of public ownership in recent years have taken place, not by the action of Socialist Governments, but under Conservative or bourgeois auspices. This applies, for instance, to the British Electricity Supply Act, which set up the " grid " system, and made the bulk transmission and sale of electric current a public monopoly.

§ 2. WHAT IS SOCIALISM?

SOCIALISM in effect does not consist in the establishment of public ownership of industry, though, of course, it involves this. It is quite possible for a wide range of industries and services to be publicly owned in a community which remains fundamentally capitalist in its structure and outlook. The essence of Socialism is to be found, not in a particular way of organising the conduct of industry, but in a particular relationship among men. Socialists hold that

this relationship, which they desire to see established throughout the world, cannot exist where industries and services and the ownership of capital are left in private hands ; and for this reason as well as in the interests of productive efficiency they wish to socialise the business of production and exchange. But socialisation is a means and not an end—a means towards the realisation of the ideal of human equality which lies at the basis of the Socialist movement.

Equality, of course, may mean very different things. It might mean that all men ought to be equal in the sense of possessing equal attainments and capacities and using these qualities in equal measure for the service one of another. But obviously it is not within men's power to equalise capacities, even if any real meaning could be attached to the idea of such equality as between capacities of very different kinds. What is possible is to reduce existing inequalities of capacity and service by the removal of those disabilities which at present prevent the great mass of men from making the most of capacities which they do possess, at least in a latent form. Socialism obviously does not stand for equality of capacity among men ; but it does stand for a system which will as far as possible enable every man to develop to the fullest extent whatever of virtue there is in him. This implies both an educational system freely open to all in accordance with their ability to profit by it, and a greatly improved physical environment destined to prevent disease, under-nourishment, and the stifling of valuable human qualities through crowded and oppressive surroundings in the formative years of life. It implies too an improved moral environment, on which, from the time of Robert Owen, Socialists have laid at least equal stress. For, if men are to serve and to make the best of the capacities that are in them, they must have the ideal of service in their minds, and learn from a very early age to regard their capacities as powers to be developed to the fullest extent in order that they may pull their weight in the society of which they are members. This is in part

the work of education in a formal sense ; but it is also very closely bound up with the physical conditions of home environment and with the nature of the motives on which the economic system relies in getting people to work. For a cramped domestic environment is a difficult soil for the growth of moral qualities of imagination and service ; while an industrial system which makes its appeal predominantly to the motives of a narrow self-interest is unlikely to foster the higher qualities of collective responsibility in those who pass under its influence in the formative years of adolescence.

Equality. It has sometimes been suggested that the equality which men should seek to establish in their societies is equality of opportunity. This is indeed necessary ; but it is not by itself enough, for the nature of the opportunity needs to be fully defined. Equality of opportunity might mean an equal chance for all to get the better of others—a devil take the hindmost policy—which would result, not in the fullest chance of self-expression for everyone, but in the crushing out of the individuality of the unsuccessful many under the heel of the successful few. Opportunity must be as far as possible the opportunity to do useful things, to perform good service, and to develop latent capacities with this definite end in view. The democratisation of the educational machine so as to provide each child with the fullest opportunities of which he or she is capable of taking advantage is therefore not by itself enough, though it is an indispensable element in the right ordering of the community's affairs ; for a democratised education that leads on to a business system which sharply contradicts its equalitarian basis will certainly not result in the widest possible diffusion throughout the community of the willingness and the ability to serve.

It is necessary then not only to recognise the natural inequalities of men and the need for reducing existing inequalities by the provision of far more equal opportunities, but also so to organise the life of society that the opportunities

it provides shall be above all opportunities for willing and efficient service. But the foundation on which the present industrial system rests is in sharp conflict with this ideal ; for its basic assumption is that the outstanding inducement to productive effort must be either the offer of material rewards to the individual or his confrontation with the fear of the disastrous consequences of abstention from labour. The entire economic theory of the nineteenth century was based on the view that the constructive impetus to production must come from the desire of men to make, not merely a living, but as much material wealth as they could succeed in accumulating. This was indeed never a true description of what actually happened ; for although the motive of individual acquisition counted for something, and had to count in everyone's mind, many other things counted as well. The aspiring business man wanted power as well as money, and even valued the power which money brought far above the money itself ; and the workman often worked not so much from the conscious motive of earning a wage as because work was the common lot, and the tradition of his social environment sent him to work day after day without any reflection about his motives. If this had not been the case it is impossible to doubt that Trade Unionism would have been a far more insistent and menacing movement, or that the workman would have shown far less patience with his lot. But in fact most men acquiesce instinctively and without question in the conditions amid which they have grown up ; and it takes some very special cause to drive them into revolt, or even to make them really " economic men " in the sense of driving the hardest economic bargain they can for the sale of their services.

The Question of Human Motives. Tradition based on long established social habit is the most powerful force in making the present economic system work. It is reinforced by the motives on which the economists in their account of the system have dwelt to a far greater extent ; but these motives of personal acquisition, or of fear of the

consequence of loss of income through loss of employment, are secondary and of far less influence upon the minds of the great majority. They count constantly in the minds of a limited class from which the active leaders of business are largely recruited ; and they act intermittently upon the mass by checking through fear the tendency to revolt against hard conditions. But they are not, and have never been, the main driving force of the productive system.

This is a matter of great importance when we are considering how far it is possible to substitute some alternative form of economic organisation for the capitalist system. The classical economists held this to be impossible without disaster, because they believed that the mass of men were driven to work only by fear or by the hope of personal gain. But if this view is wrong, and these motives are only secondary to the force of collective tradition, the familiar case in favour of Capitalism becomes far less strong ; for an alternative form of organisation will be able to rely on this same traditional force, although it may encounter serious difficulties in the course of the transition from Capitalism to any new system.

It is not suggested that the characteristic capitalist motives, although they are secondary, are unimportant, or that men could be kept at work solely by the force of collective tradition. There must be supplementary motives to induce men to do more than tradition will by itself cause them to do ; and, if the familiar capitalist motives are to be dispensed with, other motives no less strong must be found to replace them. What, in the view of Socialists, who advocate a fundamental change in the basis of the economic order, are these new motives to be ?

It is a part of the Socialist thesis that the force of the collective impetus to work is greatly diminished in existing institutions by the influence of class antagonism. The great mass of men, whether they resent their exclusion or not, are not conscious under modern large-scale Capitalism of possessing any real responsibility for the successful conduct of the processes of production. For responsibility comes

necessarily with power, and those who have no control cannot be expected to feel responsible. It is for this reason, say the Socialists, as well as on account of the monotonous and uninteresting character of much of the work of modern industry, that the service given is often perfunctory and unwilling. Men sell their labour for a wage, and at most are apt to feel only the obligation to earn this wage by giving what they regard as a reasonable economic return. This applies above all where large-scale business becomes so huge and impersonal as to destroy all sense of individual relationship between employer and employee ; and it can always, of course, be aggravated by unsympathetic and unimaginative management. Where these conditions prevail, the controllers of industry are compelled, by the necessity of keeping down costs, to endeavour to meet the absence of a spirit of willing service on the part of their employees by driving them harder through the speeding up of the pace at which the machine revolves, or the product passes on a moving platform before a sequence of workers who have to do their appointed task in a period of time set by the pace of the machine ; but the more this method of driving men harder is resorted to, the more the spirit of willing co-operation and the sense of responsibility are undermined. For the very essence of these forms of speeding up must be to remove the responsibility for output from the worker and transfer it to the machine, of which the worker becomes the merely automatic auxiliary. Undoubtedly such practices are destructive of the spirit of willing service, and bad for citizenship as well as for industry ; for how men are treated in their hours of work profoundly affects their attitude in their hours of leisure.

The Idea of Service. It lies at the very root of the faith of Socialists that men and women are capable of giving and of sustaining more effective service than Capitalism is able to command from them, under the impulsion of motives largely social. Socialists believe that it is possible to build upon the tradition which makes work the

common lot a positive sense of responsibility for working well in the common service. Modern production, they point out, is essentially a social process carried on by groups of men in close collaboration, so that the efficiency of the service as a whole depends on the contribution which each individual makes to the work of the group. They believe that under these conditions it is possible to build up a sense of group loyalty and responsibility which will induce men to give of their best, on two conditions. The first of these conditions is that the work shall be in itself worth doing, in the sense that it is obviously designed to supply a real need, and one which those engaged in it are in a position to understand. This implies, not only that the goods produced shall be useful goods, but also that there shall be some guarantee that they shall be distributed to those who need them. It involves therefore not only the elimination of useless toil in producing goods that are not worth producing at all, but also a right system of distribution, calculated to put the goods made to the best possible use in the interests of human happiness.

The second condition is in practice no less important. It is that those who are called upon to do the work shall feel that from top to bottom the organisation of the industry to which they belong is a process in which everybody else is playing his part, on the basis of the same motives and incentives as apply to themselves.

The workman or the clerk does not feel this to-day, even where the responsible managers of the business are like himself in receipt of a salary, and are therefore technically employed persons. For these salaried controllers of the business appear to him as representatives of the management whose concern it is to operate the business so as to produce the largest possible profit for a body of private shareholders. There is, in these circumstances, no community of purpose among the whole body of workers by hand and brain engaged in the business—no "team spirit," except where this is achieved by quite exceptional qualities on the part of those responsible for the management. But this

absence of team spirit has highly unfortunate effects on the efficiency of industrial organisation. It produces constant friction and a recurrent sense of injustice ; and above all it compels the substitution of drive for leadership as the spur to productive effort. It is impossible to measure the loss of productive efficiency which arises from this division of the producers into antagonistic groups, and from the failure to enlist the spirit of communal service on the side of productive effort.

If the workmen, or rather the whole body of employees engaged in a business, from the manual workers to the higher grades of management, can be given the sense that efficiency is a social responsibility falling upon them all as a group, that the work they are called upon to do is worth doing and will be put to good use, and that they will be left as a group the widest possible discretion to organise it in their own way, Socialists believe that it will be possible very rapidly to reduce the dependence of industry either on material incentives to higher production, or on the spurring of men to greater activity by fears of unemployment or by making them subject to the automatic drive of the machine. It is not suggested that it will be possible to dispense wholly with material inducements to higher individual effort, but only that it will be possible greatly to reduce these as the new motives are brought effectively into play. There are bound to be difficulties of transition while the old system is passing into the new ; and it is certain that the response to the new stimuli will come far more easily from young workers who grow up in the new atmosphere than from those who have long been accustomed to the old conditions. But Socialists believe that, if the right social environment is provided for the growth of the new motives by a reform alike of the educational system and of the organisation of industry, the transformation in men's minds of the attitude towards work can be made very rapidly indeed ; and they point to the example of Russia as showing at what speed the new social motives can be brought into play if they are given a new environment in which to

work. It is true that the Russians have preserved the piece-work system, and have by no means thrown material inducements to production overboard wholesale; but it is no less clear that less weight is being placed upon these factors in inducing industrial efficiency, and more on the willing response of the mass of employees to new motives and to the enthusiastic leadership of the "shock brigades" of young Communists in the Soviet factories.

§ 3. THE CONTROL OF INDUSTRY

During and immediately after the war there arose among the workers in many countries a new demand for a share in the "control of industry." This demand was indeed older than the war. It was put forward by the Syndicalists in France under the original inspiration of Fernand Pelloutier at the end of the nineteenth century. It made its appearance in the propaganda of the Industrial Workers of the World in America; and it was a cardinal point of doctrine in the Guild Socialist Movement which began to grow up in Great Britain under the influence of the *New Age* in the years before the war. But the conditions which existed during the war gave to it a new and more extensive impetus; and when the working-class bodies restated their programmes after the conclusion of hostilities the claim for "workers' control" everywhere occupied an important place among their demands. It was put forward in Great Britain by the miners, the railwaymen, the postal workers, and many other groups. It was acknowledged in France by the *Confédération Générale du Travail* with its programme for industrialised nationalisation. It appeared in post-war German programmes of socialisation; and it was restated in many forms in the United States, from the "blue print" propaganda of the Industrial Workers of the World to the once famous "Plumb Plan" for the railroads.

These various schemes differed in detail; but they had

all certain features in common. In all of them it was contemplated that the running of industry must become to a considerable extent a Co-operative or Guild affair, entrusted to the whole body of workers engaged in each service organised in some form of autonomous corporation. It was recognised that no industry could be left to run itself absolutely, and that such matters as the pricing of the product and the remuneration of the producers must be decided by some authority wider than that of the industry itself, and able to speak on behalf of the community as a whole. But, subject to these general conditions, the idea was that each industry should be left to run itself as a self-governing group, as far as possible under leaders chosen by those whose activities they would have to direct. It was felt that the concession to each industry of this responsibility for its own self-government would go far towards creating a " team spirit " among the whole body of those employed, and would provide for the conduct of industries in the public interest, while avoiding the dangers of bureaucratic control.

This idea flourished greatly in the years of acute industrial unrest which immediately followed the war. The Trade Unions were at that time in a strong position ; and it seemed likely that big practical advances in the direction of " workers' control " would be made. But the slump of 1921 destroyed for the time being the power of the Trade Unions, which soon found themselves with their hands full in resisting demands for wage reductions and worsening of labour conditions, and with no strength left to press forward fresh demands of their own. The Guild Socialist Movement and the other movements aiming at " workers' control " suffered almost complete eclipse in the following years of depression ; but something of their doctrine became incorporated in the policy of Socialism throughout the world. For it at any rate taught the Socialists to mistrust plans for bringing the operation of socialised industries under the direct administration of the State, or for conducting these industries by bureaucratic methods. The ideal in

the minds of Socialists came more and more to be that of providing for the fullest possible control by the community as a whole over industrial planning and policy in matters of general concern, while leaving the detailed conduct of industry as far as possible in the hands of functional corporations of one sort or another.

Forms of Public Control. But there remained differences of opinion concerning the structure of these functional bodies. Some wished to set up boards of experts appointed by the State from above, responsible to the State, and occupying, in relation to the main body of workers engaged in each service, a position closely analogous to that of the employer or salaried manager in privately-owned industry ; while others urged that the governing bodies of the various industries must be so constituted as effectively to represent, at any rate in part, the various grades and sections of workers actually engaged in the industry. The first view was supported on the ground that it was necessary above all to place in positions of control men who would be able to carry on industries with the highest technical competence, and that this result would not be secure by adopting a representative basis of choice. The second view was defended on the plea of the necessity for giving the whole body of workers a sense of collective responsibility for the efficiency of the service, and a feeling that they " counted " as co-operators and not as mere hands in its conduct.

Obviously there is a great deal to be said for both these points of view. The Socialist who aims at taking over industries clearly cannot afford to have them conducted with anything less than the fullest degree of technical efficiency that can possibly be secured, especially as the industries which are most likely to be taken under some form of social control are those which stand in need of the greatest amount of technical reorganisation. On the other hand, if the technical manager appointed by the State replaces the manager appointed by the private shareholders, and no

other change is made, the position of the workers engaged in industry and their attitude towards their daily work will continue to be unsatisfactory, and they will be unlikely to give the new response which is demanded of them. It is therefore necessary, in as far as industries are to be socialised at all, to endeavour to reconcile these two points of view. In the interest of technical development the actual managerial body for each industry as a whole will have for the present to be constituted on a basis of appointment by the State on grounds of personal fitness for the job, and not of representation of any particular group or interest. But there is every reason why the full-time experts who are placed at the head of great socialised concerns should include men drawn from the ranks of the manual workers and trusted by them ; and there is every reason too for providing some sort of representative council drawn from the entire personnel of the industry, and giving to this council a steadily increasing amount of power in the regulation of the industry's affairs. The powers of such councils may have to be limited at the outset, until there has been time for the new spirit of collective responsibility to take root ; but thereafter there is every reason why they should be rapidly increased so as to transform the industry, as far and as fast as it can be transformed without danger to its technical efficiency, into a self-governing organisation upon a representative basis.

This is a matter of internal organisation in each industry that passes under some form of socialised control ; but it will be necessary also to provide for the co-ordination of the various socialised services in accordance with the conception of a national economic plan. Each industry or service would presumably be organised as a largely autonomous corporation looking after its own internal affairs—a body corresponding to the " combination " as it exists in Russia to-day—and in the larger industries these corporations would certainly be broken up into smaller largely autonomous sections, sometimes for a particular area and sometimes for a particular branch of production. These

smaller groups would correspond to the Russian " trusts " which are members of the various " combinations." On a larger scale it is probable that closely related industries would be linked together through some sort of controlling Commission—for example, the Power and Transport Commission proposed by the British Labour Party as part of its plan for the socialisation of the fuel and transport services. This commission would have under it sectional corporations for the railways, road transport services, electricity, coal and possibly other branches of production ; and, as the structure of socialisation was developed further, there might come into being similar co-ordinating commissions for other industries, for the metal industries, for example, or for the textile industries, while the Co-operative movement might occupy a similar position in relation to the distributive trades and to a wide range of manufactures destined for household consumption. Finally, Socialists envisage as the supreme co-ordinating body for the socialised industrial enterprises some sort of national development commission, acting on the advice of a national planning authority, much as " Gosplan " in Russia is related to the Council of Labour and Defence.

Economic Councils. There has been in recent years a considerable development of public and semi-public enterprise which bears some resemblance, at any rate on the surface, to the structure suggested above. Thus, the socialisation of the bulk transmission of electrical current in Great Britain was brought about by the setting up of a statutory corporation, the Central Electricity Board, for the conduct of the socialised service ; and there has been a similar tendency to provide for the operation of socialised public utility services through statutory corporations in Germany, Canada, and even the United States. There has been also, in one country after another, a movement in recent years to set up central economic councils of one kind or another, and to confer upon these bodies advisory functions which are at least an adumbration of the idea of

qualities of the party system appear chiefly in those countries where political life is dominated by two great rival parties which occupy alternately the rôles of Government and Opposition. They appear much less in countries where parties are more numerous, and Governments have as a rule to be based upon shifting coalitions of relatively small groups ; for in these cases Governments are apt to lack the constructive coherence necessary for the carrying through of ambitious policies, and opposition takes the form rather of a fractional advocacy of particular interests than of an alternative policy covering the whole field. It is generally admitted by advocates of the familiar system that it works best where there are only two parties, or at all events where two rival parties dominate the situation ; and the weakness of parliamentary institutions in post-war Europe has been largely attributed to the multiplication of political groups and the consequent dependence of Governments on unstable and imperfectly united coalitions.

The Russian conception—and we may add the Italian also—of the party system is based on a quite different point of view ; for in the minds of Communists and Fascists alike the need is not for two parties to fulfil alternately the rôles of Government and Opposition, but for a single party strongly enough organised in the country as well as in the legislative assembly to carry through a constructive and continuous policy extending far beyond the normal life of a single elected legislature. This difference of view is obviously based on a different idea of the work which government is called upon to do. The two-party system has been praised as a means of ensuring the stability and gradual adaptation of an existing system regarded as satisfactory in its essential qualities. The defence of it has been that it does preserve the existing order by protecting it against discontents through the elasticity which changes of Government provide. But it is essential to the working of the party system on these lines that the two rival parties which dominate the situation—however much they may disagree about secondary questions—should be in close

agreement on fundamentals. Thus in the nineteenth century the Conservative and Liberal parties in Great Britain differed on a wide range of matters which did not affect the fundamental structure of society, but were in essential agreement in wishing to preserve both Capitalism and the parliamentary institutions which went with it. And in America there was even less difference between the fundamental ideas of the Democratic and Republican parties than between Liberals and Conservatives in Great Britain. A party system of this kind becomes unworkable and inappropriate as soon as there arises a party which, so far from accepting the fundamentals of the existing order, desires a complete change of social system, or at any rate as soon as such a party becomes strong enough to occupy a position of primary importance in the political life of the country. For, if two parties which disagree about fundamentals are to alternate in office and opposition, it is plain that each of them will spend most of its time undoing the acts of its predecessor. In these circumstances pursuit of a constructive policy will become impossible; and the country is bound to be ill-governed, and to get the best out of neither of the alternative systems which are being advocated.

The Old Party System and the New. When therefore a fundamental difference of opinion about the right basis of social organisation comes to dominate political life, the old party system breaks down; and it is natural that each of the rival forces should desire to establish itself permanently and securely in power, and to remove as far as possible all prospect of a return of its rival to office. But this does not mean that a country which reaches this situation can afford to dispense with party organisation. On the contrary, it will need a stronger party system than ever because of the magnitude of the changes which are in question. It will be impossible to carry out these changes merely by the strength of a parliamentary majority; for their effective enforcement in the country will require the positive co-operation of large bodies of men through the

length and breadth of its territory, and a widely diffused understanding of the aims of the dominant party and the methods by which they are being pursued. Party will therefore be stronger than ever ; but the party which gets power will endeavour not merely to secure for the moment the assent of the population to its continuance in office, but to break up and destroy the organisation of its rival in order to put it permanently out of action. This has happened in both Italy and Russia ; and opposition to the Communist party or to the Fascist party is regarded in these countries as treason to the State. This suppression of rival political opinion is widely denounced as undemocratic and illegitimate ; but it is difficult to see how changes as fundamental as those which Communism at any rate desires to bring about could possibly be accomplished if there existed a rival party machine constantly appealing for support against the Government, and liable at any moment to bring the Government's life to an end. For the establishment of a Socialist system cannot be achieved merely by passing a few Acts in Parliament or Congress. It involves the continuous pursuit of a well considered and systematic policy over a long period of years.

These, however, are conclusions which even Socialist opinion over a large part of the world is still profoundly reluctant to endorse. For some countries, notably Great Britain and North America, have the two-party system so deeply in their bones that they find it very difficult to think in any other terms. Government is in their minds essentially a system of alternating party controls, or at any rate postulates continuous opposition by a rival party which is always an aspirant to office. They are not prepared to admit that this two-party system depends for its successful working on the existence of a fundamental community of assumptions between the rivals, and is therefore an instrument well adapted for the preservation of an existing order but exceedingly ill-fitted for the bringing about of far-reaching change. Consequently Socialist parties, when they become strong enough to assume office, are apt to find

themselves involved in a self-contradictory policy. They are trying so to act as to change the existing order and to substitute for it a new one based on radically different assumptions ; but at the same time they find themselves driven to maintain the existing order in order to avert a collapse of economic activity. They cannot within the brief assured tenure of office which is theirs even attempt by parliamentary means the radical alterations which are necessary for laying the foundations of the new system; for these, pursued by parliamentary means, are bound to take not merely years but decades to bring into effect. But until the foundations of the new order have been laid, it is essential to keep the old order working ; for the people cannot be left to starve, or even to suffer serious discomfort, and the penalty of involving them in such hardships will be the early fall of the Government from office. It is true that most of the Socialist Governments which have held office in post-war Europe have been further handicapped by the absence of a clear majority, and have therefore had in effect to govern with the assent of some fraction of the older parties. This has greatly increased the difficulty of their task in attempting any constructive work ; but it is more than doubtful whether, even if they had had parliamentary majorities behind them, they would have been able to do much more. For to govern on the assumption that you may fall from office at any moment is to be precluded from taking any steps that are calculated to put the existing system out of action—but without taking such steps it is impossible to proceed any distance with the constructive work of Socialism.

It does not of course follow that, because Socialist parties cannot hope to introduce Socialism under the existing party system and by purely parliamentary means, the only alternative is the policy of violent revolution advocated by the Russian Communists ; for this policy, while it may have been the only possible course in Russia, is clearly impracticable in such countries as Great Britain and the United States. A party cannot make a revolution unless a

large section of the people is in such a mood as to desire revolution, or to be capable of conviction that revolution is the only means open to it of establishing tolerable conditions of life ; and this emphatically is not at present the view of the vast majority in either Great Britain or the United States. It may indeed come to be the attitude of the majority of Germans in face of the complete breakdown with which the German economic system is threatened ; and I am not saying that it is inconceivable that it may at some future stage come to be possible in the United States or even in Great Britain. But in these two countries, or in France, it certainly is not possible to-day, or likely to become possible in the near future ; and Socialists in these countries, even if they recognise the impossibility of a purely parliamentary strategy for the establishment of Socialism, can find no answer to their problem in the acceptance of the Communist dogma.

This may mean one of two things—either that the countries to which this situation applies are not ripe or ready for Socialism at all, or that there exists a third policy which is neither Social Democratic Parliamentarism nor Communist Revolutionism. In the United States the first of these alternatives for the present holds the field ; for there exists in America no strongly organised Socialist movement capable of either parliamentary or extra-parliamentary success. The situation in America may change rapidly if economic adversity continues ; but even so it is bound to be a matter of time to build up any coherent force aiming at a radical transformation of the basis of American society. The United States of America is the one western country which for the present remains securely within the assumptions of Capitalism—for the same can no longer be said of any European country to-day.

In Great Britain, on the other hand, there has existed for a long time a strongly organised Socialist movement in effective control of what has come to be one of the two leading parties of the State. The Labour Party is not indeed completely Socialist ; for through its Trade Union

and Co-operative connections it includes many non-socialist elements. But its driving force has throughout its existence been Socialist ; and the great majority of those who lead it would regard themselves as beyond question Socialists, in the sense that they stand for a radical transformation of the basis of economic life, and for the supersession of private enterprise by a collective system of ownership and control. It is in Great Britain, if anywhere, that the third alternative of a Socialist policy neither purely Parliamentary nor purely Communist is likely to be tried out.

§ 6. SOCIALISM IN GREAT BRITAIN

THE BRITISH Socialist movement differs in certain very important respects from the Socialist movements of continental countries. Above all it has never been Marxist in either its phrasing or its ideology. Marx indeed lived long in England ; and there have always been English Marxists. But British Socialism, ever since the days of the Chartists, has pursued a largely independent course of its own. From its revival in the 1880's up to the present time it has been far more under the influence of Fabians and ex-Liberals than of men trained in the Marxian school of class consciousness. It has never used to any considerable extent the phraseology of class war or of the Materialist Conception of History ; and it has always laid stress rather on the ends to be attained than on the struggle of classes as the means of attaining them. It has been in this sense Utopian, in that it has made its appeal by presenting a vision of the superior merits of a Socialist society far more than by an endeavour to stir up hostility against the present governing class.

This has been possible mainly because of the greater liberalism of British political life. Great Britain has not, like Germany, preserved in her social structure large elements of absolutism and agrarian feudalism. She has

not, like France, experienced a series of revolutions which have taught her the tactics of suppression of inconvenient opinion. She has not, like the United States, included in her population large alien elements which have been a perpetual source of unrest, and have bred in the minds of the American public an intense desire to enforce uniformity at all costs. Her Capitalism has seemed for a century the most stable and unchallenged in the world, and the best able to give full freedom to critics precisely because these critics have not seemed dangerous. British Socialism therefore has never undergone since the days of the Chartists any period of persecution or repression. It has been left to develop freely in a civilisation which was throughout the nineteenth century giving the workers, as well as every other section of the community, a steadily improving standard of life. In these circumstances it came to be a movement not so much of revolt as of logical development, representing Socialism as something which would grow by a gradual and painless evolution out of things as they were, and passing by easy stages from the advocacy of factory legislation, workmen's compensation, old age pensions and provision for the unemployed to insistence on the need for public control of vital industries and services in the common interest.

Fabianism. The economic theories of the British Socialists have been in harmony with this conception of policy. The Fabians based their economics in the famous *Fabian Essays* not on Marx but on Mill and Jevons. Just as Mill had passed from the utilitarianism of his father, which involved the most uncompromising gospel of *laisser-faire*, to a re-stated utilitarianism which defended social legislation and a considerable instalment of Socialism itself on the grounds of "the greatest happiness of the greatest number," they passed beyond Mill to an emphasis on completer Socialism as necessary on Benthamite grounds. This made British Socialism seem hopelessly moderate and unscientific to the great mass of continental Socialists ; and

British Socialist policy in fact remained moderate as long as British Capitalism continued to work so successfully that there was no fundamental difficulty in exacting from it continually fresh concessions in improved social services and a raising of the standard of life.

But the proof of the pudding is in the eating ; and the paradox of the situation in post-war Europe is that the continental Social Democratic parties, for all their Marxian phrases and insistence on the class war, have certainly been in action no further to the left than the Fabian Socialists of Great Britain. When action has been required of them Marxian phrases have counted for little, and the exigencies of the parliamentary situation for a great deal ; for the truth is that the pursuit of a purely parliamentary policy carries with it a reformism in practice closely akin to Fabianism, and no employment of revolutionary phrases will greatly influence the policy of a party which is acting within the parliamentary system, and attempting by electoral propaganda to win over a precarious majority of the voters to its side.

British Labour Policy. But British Socialism—the foremost exponent of this moderate and gradualist policy—has of late years encountered increasing difficulties as its electoral influence has grown ; for in face of the post-war economic situation it has become more and more difficult to secure fresh concessions and a continuous rise in the standard of life. Capitalism, hampered by the world slump, is not at present in a position to buy off the Socialists with additional concessions ; and the Socialists themselves, when they assume office owing to the dissatisfaction of the electorate with their rivals, are no more in a position to do this because they cannot venture to bring the capitalist system to the ground. It was above all this dilemma that brought about in the Autumn of 1931 the split in British Socialism which preceded the formation of Mr. Ramsay MacDonald's "National" Government. For when it appeared that Capitalism—so far from making fresh

concessions to the workers—needed to take back some of its past gifts if it was to carry on, British Socialists were faced with a difficult choice. One possible policy was to make the necessary concessions to Capitalism, in the hope that better times would soon return so as to enable the process of squeezing the capitalist orange to be resumed ; and this was the course taken by Mr. MacDonald and a few of the other best-known leaders of the party. But the great majority of their organised following would have none of this attitude ; and among the leaders themselves, when the choice had to be made, loyalty to their followers was preferred to a policy which was, after all, no more than the logical outcome of what they had been doing during their previous tenure of office. The great majority of the Labour leaders therefore left Mr. MacDonald and went into opposition with the bulk of the Labour Party ; but they did this with considerable misgivings in their own minds because they were mostly conscious that within the assumptions on which they had previously been acting they were without an alternative policy to that which they had rejected. The Labour Party therefore appeared before the electorate in the General Election of 1931 without any clearly conceived policy of its own ; and its defeat, made more thorough by the fears of the voters and the loss of its best-known leaders, really followed as a logical consequence of its lack of policy.

The position of British Socialism to-day is then that its traditional policy has been washed out by the difficulties of Capitalism and by the world slump, and that it has to find for itself a new policy if it is to continue as an effective political force. If it fails in this endeavour it will not indeed disappear ; for it has far too large and devoted a following among the electors for that to happen. But it will cease to be a possible alternative Government ; and with its failure any early prospect of the passing over of Great Britain to a Socialist system will vanish too. But there will be, even in these circumstances, no early growth of a formidable Communist party, for the soil of British politics

is still for the most part utterly unready to receive the Communist dogma.

There are signs that within the British Labour Party the attempt to think out the new policy that the changed situation requires is already proceeding. It is realised that the new policy must differ from the old in involving, not a series of gradual and secondary modifications of the capitalist system, but a frontal attack on the key institutions of Capitalism—above all on the financial machine, which must be brought under social control in order that it may serve as the instrument of a national economic plan.

The Socialisation of Banking. The Socialists are tending to put the socialisation of banking in the forefront of their policy, not because they agree with the "currency cranks" in conceiving of the necessary changes in the economic system as mainly monetary, but because they regard the control of capital and credit as necessary instruments for the task of industrial reorganisation, for the getting of the unemployed back to work, and for the bringing about of a more equal and adequate distribution of incomes. But a policy of this sort, involving a frontal attack on the banking system and on the control of the great basic industries, is obviously very difficult to bring about within the limitations of existing parliamentary practice. It could not be carried far or got into thorough working order within the life of a single Parliament, above all if the existing slow and cumbrous methods of legislation were left in being. The thoughts of British Socialists are therefore turning more and more towards a radical reconstruction of the machinery of legislation. They recognise that they will have at the outset to tackle the House of Lords; and their solution of this problem is likely to be its simple abolition. They recognise that they will have to reform parliamentary procedure and the Cabinet system so as to speed up the pace of legislation and to bring about a great improvement in administrative efficiency and a great increase in the centralised control of

the various departments of the State. But they have hardly yet begun to face the even more fundamental question whether, when they have come back to power and begun to carry out their new policy, they are prepared to find themselves turned out of office and have most of their work undone by the incoming Government if the pendulum of electoral opinion should swing temporarily against them. If they ever come to the point of returning to office pledged to carry out their new and more radical policy, they are likely to find that their political methods will have to approximate more closely than they at present imagine to those of Fascism and even Communism.

For the object with which British Socialists are now setting out to socialise the banks and to bring the leading industries of the country under collective control is nothing less than a speedy transformation of the entire basis of the existing economic order. It is inconceivable that a socialised banking system and socialised control over the leading industries of the country should co-exist with the continued vitality of the remaining institutions of Capitalism. To expect Capitalism over the rest of the industrial field to go on functioning even with the reduced vitality which it shows to-day would be as if a doctor tried to treat an ailing patient by cutting out his heart and then expecting him to get up and walk. If once the British Labour Party is able to go as far as its new programmes indicate that it means to go when it returns to office, it will assuredly find itself speedily compelled to go a great deal further, and to socialise one part after another of the field of capitalist enterprise from which the life blood has departed. But the wider the field over which Socialism is compelled to act swiftly in substituting new collective institutions for the capitalist institutions at present in being, the less possible will it be to observe in the transition the niceties of constitutional practice. The emergency powers which have already been invoked more than once even by British Governments since the war, which are being employed by the British "National" Government to-day, and which

have become a commonplace of the post-war political practice of most of the other countries of Europe, will have to be pressed very much further the very instant any real attempt is made to supersede capitalist by Socialist institutions in any vital part of the economic machine.

§ 7. ECONOMIC PLANNING

SOCIALISM, whatever methods and strategy it may adopt, is committed above all to an attempt to secure the fullest possible use of the existing resources of production so as to bring about a larger as well as a more equal distribution of incomes in the community. It is upon the under-use of the available productive resources under Capitalism that the Socialists above all nowadays base their attack on the existing economic order. There was a time when they were mainly critics of the mal-distribution of wealth ; but, although the force of this criticism has not been weakened, there is now added to it the even more glaring failure of the economic system to distribute to anybody nearly as much wealth as it is capable of producing. The Socialist policy, therefore, everywhere involves a fuller use of productive resources and therewith the prevention of unemployment. But it is more and more recognised that unemployment is only a symptom, and that attempts to deal with it by artificial schemes for the provision of work, while they may be necessary as palliatives, can bring no cure for the disorder of which unemployment is the outcome. Attempts to provide public work on a large enough scale to absorb any considerable fraction of the unemployed involve public expenditure so heavy that no Government—at least in Europe—can in effect sustain it ; for it would react inevitably on the ability of industry to make profits and thereby on the quantity of employment which industry would be able to provide. Work schemes are necessary, but Socialists have everywhere realised that the getting of the

main body of the unemployed back to work involves much more far-reaching measures, and above all involves that the State shall itself be in control of the normal means of providing work, and shall not need to act mainly by the improvisation of emergency schemes of relief. No State can in effect prevent unemployment or set the unemployed to work in bad times unless it controls industry, and has in its hands the means of providing for the consumption of all the wealth that industry is able to produce. But only a country which is working under a Socialist regime has the power to do this ; for in any other country the volume of employment generated by the economic system is bound to depend on the prospect of profit as it appears to the owners of industrial resources, and any attempt by the State to provide work for everybody outside the operation of the normal industrial machine is doomed to failure. National economic planning, in any sense in which it includes the full utilisation of productive resources, involves public ownership of industry and at the same time public control of the distribution of income.

What Planning Means. For what does the conception of national economic planning signify ? It requires in the first place a decision about the forms and quantities of production of different types of goods, based on a survey of the available productive resources and on decisions collectively taken concerning the amount of expansion that is to be budgeted for in each separate industry. It requires secondly a collective decision about the quantity of the available productive resources the community can afford to devote on the one hand to the provision of goods for immediate consumption and on the other to the improvement of its power to produce goods in the future. It requires thirdly that the incomes distributed for spending to the members of the community shall correspond in purchasing power to the quantities of goods made available for consumption at the prices placed upon them, and that these sums shall actually be spent on the available goods and not

either hoarded or devoted to some other use. It requires fourthly that the means to buy the capital goods which it has been decided to produce shall be placed in the hands of those who need these goods in the right proportions, and that this purchasing power too shall be used and not hoarded or diverted from the uses for which it was meant. It requires fifthly that, as fast as productive resources increase, new incomes shall be distributed commensurate with the increasing output of goods, and that these incomes too shall be rightly apportioned among the various types of goods available. And it requires sixthly that, as production takes time and the producer has to be financed during the period between his activity and the making of payment for his goods, the supply of credit for financing this period of turn-over shall be adequate—neither more nor less—and shall be distributed to those who need it in strict accordance with the decisions made under the national plan concerning the quantities in which each type of commodity or service is to be produced.

In fact national economic planning in any real sense involves a strongly organised control over almost every aspect of the economic life and above all over production, over the distribution of purchasing power in all its forms, and over the fixing of prices. It is clearly impossible for any planning of this order to co-exist with Capitalism. It may be compatible with the survival of capitalist methods or of small-scale production by independent producers in some of the less essential industries and services, or at the margins of some of the larger industries. But, if there is to be a real economic plan, the main bulk of the commodities produced must be produced under orders given in accordance with the plan. The main bulk of incomes must be distributed in such a way as to equate demand to the goods and services available; and there must be a strongly controlled pricing system because on no other terms would it be possible to estimate the quantity of any particular class of goods for which a given distribution of income in the community would create a demand. Doubtless an economic

plan may exist and yet fall short of the full implications of organised planning ; but if it falls very far short it will inevitably break down. Planning is based on the idea of a nice organised balance between production and consumption with the price system as mediator ; and if this balance is allowed to be destroyed in any essential particular the plan as a whole will not work. Any real economic plan therefore involves not merely the infusion of some Socialism into the existing system, but a transformation of the fundamental basis of economic life.

Planning in Great Britain. Let us try to envisage the main features of such a scheme as it might be applied to one of the more developed industrial countries—say Great Britain, where it would obviously have to work in some respects very differently from the working of a similar plan in Russia as we described them in the last chapter. For in Russia planning is simple in at least one important respect. There is and can be for a long time to come no problem of a surplus of any important class of industrial goods. It is certain in advance that all industrial goods which the Russians can equip themselves to produce will be eagerly snapped up by consumers as soon as they make their appearance in the market, and that the consumers will then avidly ask for more. It is certain too that all the producers' goods that Russia is capable of turning out will for some time be readily requisitioned by the rapidly developing industrial enterprises and the socialised farms. This of course would not be the case even in Russia if the distribution of income to the consumers were artificially kept down, or if the prices of the industrial goods were left free to rise to such a point as to make supply and demand balance however short the supply might be. But in fact a large part of the output of consumers' goods in Russia is sold at rationed prices, and only the surplus over basic needs at higher prices in the so-called free market ; and almost all producers' goods pass at controlled prices to the collective institutions which need them in accordance with

the plan. Moreover, it is the declared and inevitable object of Russian policy to expand incomes, which are under complete State control, in correspondence with the expansion in the supply of goods. Russia therefore has in practice no possibility of any surplus, or of anything but a shortage, of industrial goods for some time to come.

But in a country like Great Britain the situation is much more complicated; for a large part of the industrial goods —including both producers' and consumers' goods—produced in the country are made for export, and there is in most of the main branches of industrial production a substantial surplus of productive capacity over the needs of the home market, even if demand is at the maximum. Moreover in many cases this surplus would remain even if the standard of life were substantially raised; for people would want to use their additional purchasing power in buying, not more of the classes of goods which there is at present a surplus capacity to produce, but other classes of goods and services which would either have to be imported or produced in larger quantities at home with the aid of new productive resources. Great Britain under a national economic plan would therefore still be under the necessity of continuing to export large quantities of industrial goods in order to pay for imports, chiefly of food-stuffs and raw materials; and she would also have to provide for a rise in the standard of living largely by the development of new forms of production rather than by the increased use of her existing resources. It is true that the basic industries which are at present among the most serious sufferers from the depression are in the main suppliers of a host of other industries, and would experience a boom in the demand for their products even more from the development of new industries than from the increased use of productive resources already in existence. But this does not apply to the textile trades, and above all to cotton. For in the cotton industry no conceivable expansion in domestic demand could have much influence in bringing unemployed workers and factories back into use.

It may be answered that Russia as well as Great Britain

has to export in order to live, and that the only difference is that Russia exports foodstuffs and materials and imports manufactures, whereas in Great Britain this situation is reversed. But the difference is really vital. Russia can at a pinch manage with only a very small quantity of imported manufactures ; and if the market for her exports declines she will have no difficulty at all in consuming at home through a rise in the standard of living all the agricultural goods and other primary commodities she is likely to be able to produce for some time to come. But Great Britain cannot consume the cotton goods she is equipped to manufacture ; and she cannot do without the foodstuffs and raw materials which she is not equipped to produce at home, although she may be able to reduce her dependence on imports of these types by radical changes in the structure of her economic system. She must continue to depend largely on export ; and any attempt to reduce her dependence, or to raise her internal standard of life without increasing it, involves large measures for altering the character and balance of her economic life, and therefore makes economic planning on her part a far more complicated and controversial affair than it is for Russia.

The experience of Great Britain during the years since the war has abundantly shown the very great difficulties which confront any attempt to alter the balance and organisation of the economic system under private enterprise. It has been manifest ever since the collapse of the post-war boom in 1920 and 1921, first that most of the basic industries of Great Britain stand in need of a fundamental reorganisation if they are to produce with full efficiency, and secondly that the existing balance of industries is out of harmony with the needs of the post-war world.

Mechanisation and Employment. Though existing industries might be so reorganised as to lower the costs of production and distribution and thereby bring about some expansion in the market, even the most successful measures would leave a redundancy of labour that could never hope

to find re-employment at its old occupation. For reorganisation is bound to mean an increasing degree of mechanisation; and the concentration of output on the works able to produce at lowest cost will substitute full-time employment of a smaller number for discontinuous employment of a larger number of workers. No sectional measures of industrial organisation will suffice to solve the unemployment problem. For that it is necessary not only to set the older industries again in order but to develop new ones for the absorption of the displaced labour, and to generate an increase of purchasing power sufficient to create a demand for the products of these new industries.

While therefore the reorganisation of the older basic industries is an integral part of any economic plan for Great Britain, and this reorganisation is bound to involve direct action by the State, no economic plan that can be made to work can be conceived in terms of these industries alone or of production as distinct from distribution of an adequate supply of purchasing power. If national planning is to work at all it must be comprehensive, and must be directed not only to the maximum production of goods and services at the lowest possible costs in plant, material, fuel and human effort, but also to the provision of adequate markets for the whole of the goods produced. But if, as we have seen reason to believe, economic conditions in the post-war world, even apart from the temporary aberrations of world tariff policy owing to the influence of the slump, make it impossible for Great Britain to rely on exporting to foreign markets anything like the same proportion of her total industrial output as in the past, the distribution of fresh purchasing power sufficient to absorb an increasing product must take the form of an expansion of the home market, and this expansion must be so managed as to lead chiefly to an increase in the demand for home-produced goods and not for imports. That is the fundamental reason why a reversion to a Free Trade policy is impossible for the British economic system in the twentieth century.

The Future of British Agriculture. If, however, British consuming power is to be expanded in accordance with the rise in industrial productivity, without a corresponding expansion in the demand for imports, it is clear that the balance of the British productive system must be radically changed, and in particular that Great Britain must set out to decrease her dependence on imported foodstuffs and to produce a much higher proportion of her food supply at home. This view is now widely held ; but many of those who hold it make the mistake of thinking of the British food supply far too much in terms of wheat, and far too little in terms of other articles of consumption. A rise in the British standard of life would not bring about any increase at all in the British consumption of wheat ; indeed it would be more likely to cause a further diminution owing to the transference of demand from bread to more expensive articles of food. Great Britain is ill-adapted for the production of wheat at prices competitive with those of the great grain-producing areas such as Canada, the Argentine and Russia ; and while she can buy her breadstuffs cheaply from abroad there is no case at all for endeavouring to expand the wheat-growing area at home. But the position is very different in the case of meat, especially bacon, dairy produce, vegetables and fruit ; and it is in these that a large expansion of demand would inevitably follow any increase in the standard of living. Moreover, these are commodities which Great Britain is far better equipped to produce at home at prices comparable with those that she now pays for imports, provided that both production and distribution are better organised than they are to-day.

A national economic plan for Great Britain would therefore involve in the first place the reorganisation of the basic industries and the creation of new industries producing mainly for domestic demand, accompanied by an equivalent increase in the distribution of purchasing power ; and secondly a great development of agricultural production at home, combined with a restriction of the quantities

of food-stuffs allowed to be imported into the country. But whereas in the basic industries reorganisation would be accomplished by complete socialisation, in agriculture the State would, for the most part, probably content itself with a monopoly of trade in both the home and the imported product, and would leave the actual conduct of production in the hands of the individual farmers. It would indeed probably increase the number of farmers by an active national policy for the provision of small holdings, and by giving as many as chose of the unemployed an opportunity of testing out on experimental holdings their fitness for work on the land. For Great Britain is not yet ripe for any general adoption of large-scale industrial farming. It is highly desirable, as was contemplated under the Land Utilisation Bill, that experiments in this type of farming should take place ; but direct operation of most of the land by the State is not yet within the realm of practical politics.

There is, however, a very strong case for the State acquiring the complete ownership of the land in order to ensure it both the power to take suitable land without further palaver for its own farms or for small holdings for the unemployed and also in order to give it, through the granting of leases, a more effective control over the types and methods of production adopted by the farmers. At a later stage collective farming in Great Britain will doubtless become practicable ; but the first stages towards the revival of agricultural prosperity are the public acquisition of the land and the establishment of a public monopoly of the trade in agricultural products.

§ 8. THE CONTROL OF FINANCE

Clearly no policy of the far-reaching character envisaged in this conception of a national plan for Great Britain could possibly be carried out unless the State had at its command the financial machine of the country. The Labour Party in Great Britain has long advocated the socialisation

of the Bank of England, which is at present, as we have seen, in form an independent private corporation owned by its stockholders. Socialisation of the Central Bank would indeed give the government of the day power to regulate the issue of currency and to make more abundant the supply of credit ; but it would be by itself an altogether inadequate instrument for the carrying out of any comprehensive plan of national economic re-organisation. For the distribution of credit among the various claimants is the affair not of the Central Bank but of the joint stock banks ; and it would be essential to bring these too within the orbit of the national plan by a complete measure of socialisation, in order to ensure that the credit should be available for the enterprises which the State, in pursuance of the plan, wished to promote and should not be frittered away on speculation or on secondary activities so as to disturb the balance of the plan as a whole.

Nor can the State stop short at the control of credit. As we have seen, under the British banking system the banks for the most part confine themselves to the granting of short-term credits for the purposes of financing the period of turnover in industrial production. They do not provide or help to any great extent in the provision of long-term capital to be sunk in plant, buildings and other durable productive assets. These are at present provided either out of reserved profits or by means of appeals to the public to invest in stocks, shares or debentures of industrial concerns. We have seen that this business of arranging for the provision of capital has been in the past organised far more effectively in Great Britain in respect of capital destined for export than for meeting the needs of domestic industry. But if a national plan is brought into being large masses of capital will obviously be required for the re-organisation of old and the development of new industries at home ; and it will not be possible, under present conditions, for these resources to be provided out of reserved profits. They will have to come either from the funds available for investment in the hands of the public or from the

State itself; and if the State provides them it will have to do so in one of three ways. Either it will have to borrow the money from its citizens; or it will have to tax its citizens for the provision of capital as well as for meeting current expenditure; or it will have to create the money required by means of the banking system—that is, by a form of inflation. The second of these courses is impracticable on any large scale; for the State will need for current purposes all the revenue it is able to raise by means of taxation—save to the extent to which it increases the taxes on inheritance and applies the proceeds as capital so as to become the owner of industry to an increasing extent as the present owners die. But there are limits even to the use of this method; for if the taxation of inheritance is made far more drastic than it is to-day it will be impossible for the State to insist on payment of the tax in cash, and it will have to be made in stocks and shares and similar tokens of ownership which the State will then have to retain in its own possession and not throw on the market with the inevitable result of destroying their value.

Public Control of Investment. The larger part of the capital required must therefore be provided either by the mobilisation of investible funds in the hands of the public directly or *via* State borrowing or through the banking system. It is obviously desirable to adopt the first of these methods to the fullest possible extent. I am assuming that under the national plan industries which are socialised, and such bodies as Import Boards or State Marketing Corporations, will be organised as autonomous institutions with a corporate character of their own, subject to State control in matters of policy, but left free in detail to manage their own affairs. These bodies can either be allowed to borrow money directly from the public, with or without a State guarantee of interest and principal, or perhaps of interest only, for a limited number of years. This is the method followed in the borrowings of the Central Electricity Board and of other institutions which are in the

nature of public corporations. Or these corporations can get their capital in the form of loans or advances from the State ; and in that case the State, by means of a National Investment Board or some similar body, can borrow from the public the sums which it needs for lending and investment in the various public corporations under its control. There is no reason for preferring either of these methods to the other. The choice between them is a matter of expediency, to be decided separately in each particular case. Certainly a National Investment Board empowered both to employ existing public funds and to borrow money from the investors for re-lending to publicly owned enterprises will be an integral part of any scheme of national economic planning.

What, however, is to happen if the investors, scared at the oncoming of Socialism, refuse to lend to the State? If they are left full freedom to use their money elsewhere, either at home or abroad, they will clearly be in a position to wreck any national economic plan which the State puts forward, by upsetting the proposed balance of the national economic life. It will therefore be indispensable for the State which embarks on a serious policy of economic planning to take full power to control the investment of capital, not only overseas but also at home. Capital issues made upon the London market will have to require the sanction of the State, acting probably through the National Investment Board as an advisory agency.

But, even so, investors may refuse to lend their money to the State, and may even prefer, as they have largely done during the present slump, to leave it lying idle in the banks at home or abroad to using it in any form of productive enterprise. They will have to be prevented from removing it abroad by State control of foreign exchange. For a flight from the pound would obviously threaten the stability of the national currency and of the economic system as a whole. And if, prevented from taking their money abroad—though the prevention could not be 100% effective—they leave a large part of it lying unused at the

banks, the State will have to fill the gap left by this unused money by using its power to create new money by the agency of the banks. Nor would this creation of money have any inflationary effect, but only the effect of preventing artificial deflation, as long as it was being used only to replace resources which the owners were refusing to apply to productive uses. While therefore the use of bank resources as capital is in normal times a dangerous expedient, it is indispensable as an exceptional measure for counteracting an investors' strike ; and a State pursuing a comprehensive national economic plan could not for a moment hesitate to use it if the necessity arose.

CHAPTER XIII: THE WORLD OUT-LOOK

1. The First Alternative—The Restoration of Capitalism
2. The Second Alternative—The Supersession of Capitalism

§ 1. THE FIRST ALTERNATIVE—THE RESTORATION OF CAPITALISM

TO-DAY, BEFORE a world slump without parallel in the memory of man the world stands hesitant, doubtful what course to pursue. The few who are still for doing nothing in the hope that if we put our trust in Providence the slump will somehow of its own motion come to an end and generate a new period of prosperity can be safely disregarded ; for in the light of the analysis contained in this book it is plain enough that the causes of the depression go far too deep for mere passivity to be a possible attitude. The world stands in need of positive measures to bring it out of the present depression into the greatly increased prosperity which man's command over nature now makes possible. But what are these constructive measures to be ? Nothing is being done to-day largely because there is no agreement on this fundamental issue.

Broadly, there are two alternatives before us. The one is a determined attempt to reconstruct the capitalist system —by removing the more obvious causes of mal-adjustment both in the internal affairs of each country and in the relationship between nation and nation, by liquidating as far as possible past mistakes, especially those which have been left behind as the legacy of war, and by endeavouring to correct with the aid of a more enlightened management of

financial and industrial affairs the recurrent tendency of Capitalism to let purchasing power fall behind the expansion of productive forces. The other course is to recognise that the capitalist system—valuable as it has been in the development of productivity during the past two centuries—has now out-lived its use, and to set about with all possible speed, and with a concentrated and disciplined effort at reconstruction, the making of an alternative economic order based on different principles and a different appeal to human motives. Which of these courses the world will ultimately decide to adopt still remains uncertain, and it is indeed clear that at the present stage there will be no agreed choice. Russia is fully committed to one course and the United States to the other ; and between these two extremes the rest of the world hovers uneasily, endeavouring to make up its mind, and suffering sharp internal divisions because it cannot resolve its doubts. Let us, try, as clearly as we can, in this concluding chapter to set out what is involved in each of these two alternative methods of rebuilding the shattered structure of industrial organisation ; for if we cannot hope to resolve the dispute between their respective partisans we may at least make the issues plain, and thereby simplify the decision which must in the last resort be made by each individual for himself.

Let us for the moment rule out of account all attempts to replace Capitalism by an alternative system and concentrate our attention on the implications of the attempt to set the capitalist system once more firmly on its feet. In order to indicate the necessary conditions for a revival of Capitalism it is necessary to recapitulate briefly the obstacles in the way. These are to a large extent the legacies of the War and the Peace. For it is hardly possible to doubt that, if there had been no war in 1914, Capitalism would still be functioning at least tolerably in the great majority of countries. The Socialist movement would no doubt have grown stronger almost everywhere than it was in 1914 ; but it would not in most countries—and in all probability it would not in Russia—have reached the point of actually

assuming control of national affairs, or even of seriously menacing the existing order. There are underlying causes of the difficulties of Capitalism that have nothing to do with the war, save in the sense that the war was itself a product of these causes ; but if there had been no war the forces making for the dissolution of Capitalism would have worked their way much more slowly, and would hardly yet have reached the stage of confronting the world with a plain and immediate choice between two rival systems of economic organisation. We can therefore consider first of all those troubles of world Capitalism which are the direct outcome of war and of the conditions of peace ; and we can then proceed to consider separately the underlying causes of disequilibrium and decay.

The Legacies of the War. In the first place, the war itself caused a great dislocation of world trade and a disturbance of the existing balance of the economic system in both the belligerent and the neutral countries. It administered a very strong stimulant to those industries which directly supplied the needs of the war ; and it held back those other industries which were mainly concerned with providing for the needs of the civilian population. It caused great changes in the character of national production in every country ; and it compelled those areas which had relied for a large part of their manufactured goods on exports from the belligerents to do all they could to stimulate the growth of manufactures within their own borders. It accustomed men in all the belligerent nations to think in millions and hundreds of millions without turning a hair, and to regard the economic problem as one of getting the required commodities produced as quickly as possible and in the largest possible quantities, almost without consideration of the costs of producing them. It enabled the world by emergency methods of organisation, based on a great extension of centralised control over industry, to produce goods in total quantities far in advance of world production in pre-war days ; but it also destroyed a large part

of this additional production as fast as it was made, and caused new capital to be used largely in creating assets which owed their value to war-time demand and were bound to depreciate heavily as soon as Governments no longer needed to keep huge armies supplied with an endless stream of munitions of war, khaki clothing and other elements in the commissariat of the fighting forces. The world's productive effort during the years of the war was altogether extraordinary in its demonstration of the huge powers of production at man's command ; for, despite the large proportion of the manhood of all the belligerent nations that was taken wholly away from productive work and the high proportion of the total output that was put to purely destructive uses, a large part of the world's population succeeded in living between 1914 and 1918 at a higher standard of consumption than ever before. The war in fact provided the most convincing demonstration of the enormous growth in man's command over nature and of the huge increase in output which the centralised control of the national life everywhere made possible.

The Attempt to Return to Pre-War Conditions. The trouble came when the world attempted to return from war to peace, and when the restoration of pre-war " normalcy " became everywhere the slogan of the parties in power. For the return to pre-war " normalcy " was an impossible policy in face of the changed economic configuration of the post-war world. The countries which had been compelled to produce for themselves goods which they had previously imported were not in the least likely to abandon their newly-won industries and to return to their pre-war methods of supply ; while the change-over from the war-time productive system to one more adapted to the needs of peace was made under the influence of a misunderstanding of the conditions of the post-war world market. Instead of trying to build up industries adapted to the new needs and marketing conditions of the post-war world, each of the older countries endeavoured as far as possible to restore

its industries to the position which they had occupied before 1914; and the short-lived post-war boom encouraged the delusion that this could be successfully brought about. Accordingly, the early work of industrial reconstruction in the older countries was carried out largely on wrong lines; and much of the new industrial equipment created at very high cost in 1919 and 1920 was found to be useless when the immediate post-war boom collapsed.

For, even apart from the stimulus given to the development of manufactures in the neutral countries, the war and the peace settlement by redrawing the world's political frontiers radically changed the conditions of international trade. The political frontiers of Europe especially were greatly lengthened by the partition of Germany, the break-up of the Austro-Hungarian Empire, and the creation of new border States carved out of the territory of pre-war Russia. All over Europe the Peace Settlement created new small States at a time when the progress of the world economic system called emphatically for larger areas of free exchange. Each of these new countries desired as far as possible to make for itself a self-subsistent economic life, and therefore proceeded to build up a tariff wall round its political frontiers, despite the obvious inadequacy of its home market to admit of the economies of large-scale production in the great majority of the industries which it was attempting to foster. The older exporting countries found their customary markets largely closed to them by this rise of new tariff barriers and similar obstructions in the way of trade. But they had rebuilt their economic systems on the basis of an improved technique which could only operate economically if they were able greatly to extend their exports of manufactured goods. Accordingly there ensued, especially after the re-entry of a rationalised Germany into the world market from 1924, a cut-throat competition among the main exporting nations, in which success in the stimulation of exports was most easily achieved either by currency depreciation or by keeping as low as possible the standard of life of the workers.

War Debts and Reparations. This situation would have been bad enough if international trade had consisted simply of an exchange of surplus products between nation and nation ; but it was in fact made infinitely more absurd and destructive by the existence of an intricate network of new capital obligations between country and country. The most formidable of these obligations arose out of the Reparations exacted by the Allies from the Central Powers and the War Debts owed by the Allied countries to one another and to the United States. But to these War Debts and Reparations were added other international obligations incurred during the period of post-war reconstruction. Debtor countries could only pay their debts—for they had no export surplus with which to pay them—if the creditor countries would lend them the money to pay with ; and they could only hope to build up an export surplus for future payment by borrowing more capital from the creditor countries for the further development of their industries with a view to competition in the export market. Thus the burden of international debts, heavy enough as a result of the Peace Treaties, was swelled much further during the years of reconstruction ; and it became plain that its continued increase by a constant stream of fresh loans from the creditor to the debtor nations had become a condition of the continued stability of the world economic system. The pressure of debts caused countries to make exceptional efforts to expand their exports and at the same time to decrease their imports ; and this accentuated the competition to sell goods in the world market and provoked retaliatory measures in the form of higher tariffs on the part of the creditor nations. Such equilibrium as was secured during the years immediately preceding the world slump was therefore exceedingly precarious ; for it depended on the continuance of international lending on a very large scale, despite the fact that the burden of debt was already top-heavy enough.

Gold, Currency and Credit. This situation, bad as it would have been in any case, was still further aggravated by the success of the movement for the stabilisation of the currencies of the various countries. By the almost universal return to the gold standard the nations succeeded in stabilising for a time the relative value of their national moneys ; but they did this only at the cost of causing a progressive fall in the world level of wholesale prices. For, in tying their currencies to gold, they made themselves dependent on their ability to acquire and to retain in their banking systems an adequate quantity of gold. But this it was impossible for them to do in face of the necessity to make debt payments which they were not in a position to meet, or were not allowed to meet, by the export of goods to the creditor countries. For in the absence of an export surplus gold was bound to flow from the debtor to the creditor countries unless the export of capital in the reverse direction continuously pumped it back. There arose accordingly, if not a shortage in the total world supply of gold, at any rate a mal-distribution in the available supply among the different nations ; and this mal-distribution had precisely the same effect that an absolute shortage would have had in forcing down the level of world prices. For the redundant gold in the banking systems of the great creditor nations was largely sterilised so as to exert no influence on prices ; and the price level came to be determined by monetary conditions in the countries which were short of gold. But, as the price level fell, the burden of debts everywhere increased in like proportion, accentuating all the evil tendencies which had been in operation even before, and causing gold to flow more rapidly to the countries where it was certain to be sterilised, credit to be restricted sharply in the countries which were short of gold, and tariffs to rise in debtor and creditor countries alike.

Post-War Debts and Prices. It did not take the world very long to realise that the earlier anticipations of the enormous sums which could be raised from Germany by

way of Reparations were merely absurd. For, if the statesmen at Versailles failed to grasp the fact that the Germans could in the last resort pay only in goods, this fact was sufficiently obvious for most intelligent people to come to understand it as soon as they were cool enough to begin thinking without passion. But it took much longer for men to understand that what was true of German Reparations was true fully as much of other kinds of international debt; and in the meantime Great Britain, in her overweening belief in her financial power, had come to an agreement to pay the United States practically in full the dollar debts incurred during the war. This agreement was a terrible calamity, not only because of the heavy burden which it placed on Great Britain, but still more because it ranged Great Britain on the side of a continued attempt to exact Reparations from the Germans in order to supply herself with the funds for meeting the charge of her debt to America. By the time other countries made their settlements with the United States there was a better understanding of the difficulties in the way of payment; and, as we have seen, the French and the Italian debts to both America and Great Britain were drastically scaled down. Meanwhile Germany's obligations were also reduced substantially under the Dawes Plan of 1924, but still remained at a level far beyond her real capacity to pay. Indeed, the Dawes Plan in some respects made the situation worse because the supposed stabilisation of conditions in Germany was followed by immense new borrowings which were applied to the reconstruction of German economic life: so that the total debt burden upon the Germans instead of falling increased rapidly during the next few years. Finally the Young Plan of 1929, purporting further to scale down Germany's obligations, actually resulted in increasing them; for, whereas the Dawes Plan had provided for a reduction in payments as prices fell, the Young Plan omitted this provision, so that the sums payable under it soon came to be larger than what Germany would have been called upon to pay if the Dawes Plan had remained in being.

The rise of post-war tariffs and the accumulating burden of international debts soon created conditions under which the successful conduct of world trade was very difficult indeed. Nevertheless, between 1924 and 1929 Europe showed, as we have seen, very great recuperative power. Production and trade alike increased ; and growing confidence was felt in her ability to overcome the difficulties of the immediate post-war years. But two things were fatal to the success of European reconstruction. The first of these was the falling price level, accentuated by the restrictive credit policy involved by the mal-distribution of gold, and the second was the dependence of Europe upon precarious American lending to balance her annual accounts. When the American boom of 1928 and 1929 caused the cessation of this lending, the immediate result was to cause a rapid outflow of Europe's remaining stock of gold and thus to cause further dislocation of financial and economic conditions in the European markets ; and when, on top of this, came the American slump with its sharp reaction on American demand in the world market other countries besides those of Europe were at once dragged into the circle of disaster. For the countries which lived chiefly by the export of foodstuffs and raw materials were also debtors ; and they now found the demand for their exports suddenly cut down by the restriction of American buying, while at the same time their debts grew heavier on account of the fall in prices. Thus after the Wall Street collapse of 1929 the threat of default appeared speedily not only in Europe but at least equally in Australia, South America and the Far East, where there was the additional complication caused by the depreciation of silver in terms of gold.

All these calamities, though some of them had their roots in pre-war conditions, can reasonably be regarded, at any rate in the intensity of their impact, as economic consequences of the war. In the first place, it was obviously a mistake from the economic point of view to go to war at all. For, even though the war may have been the product of the clash of the rival Imperialisms in the pre-war world,

victors as well as vanquished have undoubtedly lost by it in an economic sense. Despite large territorial acquisitions the British Empire, or at all events Great Britain, is much worse off now than she would have been if no war had taken place. Even France, despite her accession of wealth and her present ascendancy on the Continent of Europe, has by no means the security which was the main object of her pursuit. Only the United States can plausibly be represented as having been a net gainer by the war ; and even she has found herself as a consequence of it involved in world entanglements which add greatly to the complexity of her internal problems.

Weakness of the League. But if it was a mistake economically to go to war at all, it was hardly less a mistake to make the sort of peace which followed the conclusion of hostilities. The break-up of Austria-Hungary and the creation of a number of new wholly independent States across Central Europe were economic disasters for a world sorely in need of consolidation into larger economic units. The creation of the new States was in some cases defensible on nationalist grounds ; and up to a point it could hardly have been avoided. But the fact remains that the consequence of the war was to accentuate nationalism at a time when nationalism was becoming increasingly inappropriate as a form of either political or economic organsation for the modern world. For the conception of the modern Nation State involves economic as well as political self-determination and ultimate sovereignty ; and this, as we have seen, has meant an inevitable raising of new barriers in the way of intercourse over territories which are sorely in need of economic unity. The creation of the League of Nations has been so far a quite inadequate counterpoise to this development of nationalism based on the multiplication of Sovereign States ; for the League has had to work hitherto within the limits set by the conception of State Sovereignty, and has been unable to bring about any effective unification across national frontiers. It has indeed been largely the

sport of rival Nationalisms and Imperialisms, and has not dared to use even such authority as the Covenant conferred upon it for fear of forfeiting the support of one or other of the greater Powers. Some of the smaller nations, and particularly the Scandinavians, have endeavoured to take the League seriously, and to use it as a real instrument of international co-operation; but their efforts have met with scant success. The League has had positive value so far mainly as an agency for the collection and spreading of valuable information and in a smaller degree as a means of creating an internationalist public opinion in the various countries. The failure of President Wilson to convert the United States to participation in it wrecked its chances of transcending European quarrels; while the fears aroused by the victory of Socialism in Russia have constantly threatened to convert it into an instrument for the preservation of the *status quo* against potential Socialist aggression. To the majority of the countries outside Europe it means little: for the South Americans it is mainly a means of emphasising their independence of the United States, and the Far East has hardly been encouraged to treat it as a serious factor in world affairs by its handling of the crises in Manchuria and Shanghai. The League indeed is still a feeble affair, and the strengthening of it is made the more difficult because it is largely committed to the defence of the Peace Settlement of 1919, with all its unsatisfactory and trouble-making dispositions.

The European Economic Tangle. For the Peace Settlement, once made, is extraordinarily hard to undo. The new frontiers of Europe, however unsatisfactory they may be, cannot now be redrawn by any reversion to pre-war conditions. If larger units are to be built up in Europe, this must be done by taking the new States as a basis of action and endeavouring to promote co-operation among them. But this, as we have seen, is an exceedingly difficult task, because any approach to unity between two countries at once provokes international jealousies of a very dangerous

kind. This has been seen very clearly in 1932 in the course of the attempt to deal with the difficulties of the Danubian States. It is obvious that these States, or the greater number of them, ought to enter into much closer mutual economic relationships, involving the throwing down of the high customs barriers which at present exist between them. But the proposal to form a Customs Union among them at once arouses very strong opposition ; for the agrarian States of Eastern Europe are among Germany's most important markets, and Germany fears that any Customs Union including Czechoslovakia with these agrarian States would involve the exclusion of her manufactures in favour of the Czechoslovakian industrialists. Italy too fears exclusion from the markets of South Eastern Europe and the creation upon her Northern borders of a powerful union of States under French hegemony. The Italians and Germans therefore unite to oppose consolidation of the Danubian countries ; and in the case of Germany the position is further complicated by her desire for political and economic union with Austria, which is vetoed by the French. These countries—Germany and Italy—do not deny the need for consolidation ; but they urge that it should have a wider scope, so as to include themselves and also probably France within the ambit of the proposed Customs Union or mutual lowering of tariff duties. But when the proposal is thus widened it becomes unmanageably difficult in face of the large number of separate interests that have to be considered and consolidated. So, although there has been a great deal of talk about closer union in Europe, nothing has in fact been done ; and every day total collapse, following upon bankruptcy and default in the Danubian countries, becomes a more immediate danger.

The Peace Treaty, as we have seen, cut in half the unified economic area of the German heavy industries by handing over Alsace-Lorraine, and at least temporarily the Saar mines, to the French. This impelled the Germans on one side of the new frontier and the French on the other to try to develop two separate self-contained economic systems,

neither of which could possibly be as efficient alone as if they formed parts of a single economic area. But the political hostility of France and Germany has so far stood firmly in the way of any attempt at real economic collaboration. There have been isolated instances of joint action, as in the Continental Steel Cartel; but in the main France and Germany have remained political and economic rivals each playing for position and influence in continental affairs. Meanwhile Great Britain hovers uneasily between participation in the problems of Europe and the attempt to build up out of her world-wide Empire a consolidated economic unit. The European market is far too important to her for a European Customs Union to which she does not belong to be regarded with equanimity; but it is equally impossible for her to enter into any European arrangement which would undermine the preferential economic relations at present existing between her and Empire countries.

The Conditions of Recovery. The difficulties left behind by the war and the fresh difficulties imposed by the Treaties of Peace therefore stand formidably in the way of the attempt to reconstruct Capitalism on a stable basis. It is nevertheless not difficult to define what needs to be done if the attempt at its reconstruction is to be seriously made. The first step is obviously a drastic reconsideration of the whole problem of international debts of every kind, including not only Reparations and War Debts but also the fresh loans, public and private, which have mounted up since the war and have been swollen in consequence of the fall in prices to a total beyond the capacity of the debtor countries to bear. If this problem is to be dealt with at all, it will probably have to be tackled by stages, beginning with an attempt at the solution of the problem of Reparations, passing from that to War Debts, and then in turn to the wider problem of other public and private indebtedness of an international kind. It may not be beyond the economic power of Germany to make any payments at all; that depends on what is done to scale down

Germany's other indebtedness and to create the conditions for a revival of world trade. But it clearly is not in her power to pay anything at present or unless her other debts are revised, or even so, to pay as long as the world slump remains in being. And, even if there is a possibility that at some time in the future a resumption of payments by Germany might be possible, it is more than doubtful whether it is really worth the while of the creditor countries, for the sake of this hypothetical resumption of payments on a small scale at some indefinite time in the future, to maintain in being the acute resentment which the Germans feel at the continued imposition of the burden of war guilt. On purely economic grounds, whether Germany is ever likely to be able to pay anything again or not, the case for complete cancellation is overwhelming.

The Future of War Debts. If the problem of Reparations has to be considered alone, what chance is there of securing agreement to any complete measure of cancellation? Very little; for clearly the countries which have expected to receive Reparations are most unlikely to forgo them altogether unless they see at least the prospect of securing remission of their own payments on account of War Debts among themselves and to the United States. Nor would even the complete cancellation of War Debts by Great Britain and the United States make it easy to secure agreement to a complete cancellation of Reparations; for the French at any rate stand under such an arrangement to sacrifice on paper a large net difference between their reparation receipts and their war debt payments, and there is at present no sign that they are willing to do this, although even they at length admit that there is no prospect of collecting the sums due from Germany under the Young Plan. But, unless Europe can successfully surmount this first obstacle to a resumption of sane international relations, there is not much hope of the remaining difficulties being got over. Let us therefore assume, difficult though the assumption is, that complete cancellation of

Reparations has been in fact agreed to, either by an absolute agreement to wipe them out altogether, or, failing this, by an agreed moratorium for a long enough period for everyone to realise that in fact payment is not in the least likely ever to be resumed. What, then, will be the next step ?

Obviously an approach to America on the question of War Debts. Having forgone Reparations from Germany, the European States will be in a far better position than they are now to approach America and ask for the complete cancellation of War Debts also. But even so they are unlikely to find the Americans in a receptive mood unless they are prepared to offer something in return ; and this offer, as we have seen earlier in this book, must include a really substantial measure of disarmament as a guarantee that the sums released will not be frittered away on preparations for a new war. Disarmament and cancellation of War Debts are absolutely bound up together ; but the progress of the Disarmament Conference of 1932 does not encourage any great optimism about the willingness of the European nations to disarm. For the fact is that they will not be prepared to disarm until they have made up their minds really to co-operate in an economic sense—and we have seen the difficulties in the way of an early advance towards real economic co-operation. But let us suppose, difficult though the assumption is, that substantial progress has been made with disarmament, and that the existing tariff barriers in Europe and the other restrictions in the way of trade have been made much less onerous as the first step towards some real economic collaboration. Given this, it is by no means out of the question for the Americans to agree to a complete cancellation of War Debts ; for, although the American taxpayer would have to shoulder the burden which Europe had let drop, America stands to gain much more by a restoration of conditions of confidence in Europe than she would lose by the necessary addition to her taxes. She might, moreover, prefer letting Europe off her debts to lowering her tariffs in order to enable Europe to pay. One

or the other of these things she must do ; for unless she is prepared greatly to lower her tariffs she must either cancel Europe's debts or tacitly allow them to go by default by accepting the accomplished fact of Europe's failure to pay.

America's Overseas Investments. But the concessions demanded from America cannot stop short at this point ; for a very large part of the capital which has been invested in the world since the war is American capital, and it will be necessary for the nations which have lent large masses of capital abroad, and especially for America and Great Britain, to agree to drastic scaling down of these debts if world recovery is to be brought about. It is true that, save in a few exceptional cases, the necessity for scaling down these other debts might possibly be avoided if the desired result could be brought about in a different way—that is to say, if effective international action could be taken again to raise the world price level to such a point as to make the debt burden tolerable. This may prove to be the easier course ; but every month that passes without effective co-operation between Governments and Central Banks to raise the world price level makes the task harder ; and it may be already beyond the world's power to lift prices up again to a point which will avoid the necessity for reconsideration of debts or, in the alternative, widespread default by the debtor countries. Perhaps in the end both methods will have to be used ; there will have to be a reconsideration of debts ; but some part of the necessity for scaling down will be avoided by international action to raise prices.

The Unification of World Finance. This involves close collaboration not only between the world's Governments but also between Central Banks acting in close conjunction with Governments and as instruments of State policy. It means in effect a unification of the world banking system, not through the creation of a single world currency—for that would be premature at this stage—or even

through a universal return to the gold standard—for that, so far from achieving the desired result, would involve the world in further measures of deflation instead of helping to raise the price level to a more satisfactory height. The collaboration among the world's banks will have to be collaboration designed to raise prices by increasing the amounts of money in circulation and by the granting of credits more freely in all countries for the work of economic reconstruction. It will involve the taking of this action by international agreement and in such a way that all countries make a parallel advance, and so avoid the upsetting of their mutual relationships through the dislocation of the rates of exchange. But it will not serve for the Central Banks to work together unless they also work as the instruments of Government policy, and unless Governments in all countries take effective action to secure that the additional money put into circulation is actually used for the promotion of economic enterprise. A policy of national development in each country financed with Government aid and under Government auspices is the indispensable condition of a successful effort to raise the level of world prices. For, as we have seen, unless Governments provide an outlet for the new money, it will, in the present mood of the business world, for the most part be returned into the hands of the banks and again immobilised almost as soon as it is issued. A considerable infusion of Socialistic methods, through an extension of the sphere of governmental economic action, into the economic systems even of the capitalistic States is therefore involved in any successful attempt to set the capitalist system once more on its feet; and, even if Capitalism can be revived by the methods so far outlined in this chapter, it will not be the old Capitalism but a Capitalism transformed and including large elements of State Socialism in its make-up.

The Nemesis of Profit-Making. I have been dealing so far with those conditions for the restoration of World Capitalism which are to be regarded chiefly as attempts to

remedy the evil economic consequences of the war and peace. But, even if the disastrous after-effects of the peace can be successfully dealt with, this, while it may suffice to bring about a temporary return of prosperity through the revival of business confidence, will not, if the diagnosis contained in this book is correct, carry with it any assured return of stable prosperity. For there will remain in being the inherent tendency of Capitalism to generate out of prosperity the conditions of collapse ; and even if the world is reconstructed on a basis of larger economic units and of a liquidation of debts which will enable business to take a new leap forward, the advance will soon be brought to a halt unless effective steps are taken to ensure the expansion of consuming power at an adequate rate. For, even during the present slump while world production has been going down, the ability of the world to produce goods has been increasing faster than ever : so that any restoration of business confidence is likely to lead to an enormous outpouring of additional goods and to investment of capital on a scale hitherto unknown in the history of the economic system. If, under these conditions, the product of industry continues to be divided in the proportions in which it was being divided between capital and labour during the boom which preceded the world slump of 1929, it will not be long before the world is faced with a new slump fully as bad as the last. It will only be possible to preserve equilibrium even for a brief period by means of lending on a colossal scale by the more advanced industrial countries. The burden of debt will begin to pile up again ; and the failure to raise wages to adequate heights will engender a deficiency of consuming power which will speedily make many of the new instruments of production unusable at a profit.

It will, however, be very difficult for most countries—even if world prosperity for a time returns—to raise their wage-rates as fast as their productivity expands ; for they will still be working within a competitive system, and their ability to sell goods will depend on keeping their costs low in relation to those of their competitors. But, as we have seen,

the pressure to keep down costs falls most of all upon wages, which constitute in most trades, even after rationalisation, the largest single element in cost, and that which the employer finds it easiest to attack. There will indeed, in conditions of reviving prosperity, be no likelihood of raising wages in proportion, not merely to the rising level of prices, but also to the increasing volume of total world production. In each country the manufacturers will want the wages in other countries to rise before they start raising their own; for otherwise they will fear the loss of markets. It seems therefore that there will remain in being very powerful tendencies depressing wage-rates in relation to industrial productivity. Moreover, the return of prosperity will be accompanied by large investments of new capital in industry; and these investments will be largely used for the substitution of machinery for human labour. Even then if wage-rates rise fully as much as prices, the total wages bill will tend to decrease; and it will be necessary to raise wages fast enough to compensate for the effects of rationalisation in reducing the area of wage-employment. But it seems clear that a rise in wages on this scale cannot possibly be brought about except on a basis of international agreement. There will have to be some sort of international convention for the raising of wages as the logical sequel to the attempt to raise the world price level by international action.

International Wage Regulation. But this again will not be at all easy to bring about. In 1919, in the first flush of post-war confidence, the representatives of the nations assembled at Washington agreed upon the draft of an international Convention limiting the duration of the working day in all developed industrial countries to eight hours, and providing also for a substantial reduction of hours in the Far Eastern countries. This Convention was solemnly agreed to at the opening conference of the International Labour Organisation; but now, thirteen years later, it has still not been ratified by the great majority of the leading countries of the world. Neither Great Britain nor France nor

Germany—to say nothing of the United States—has accepted it. This seems to bode ill for the success of the far more difficult and ambitious project of regulating wages on international lines.

For there are always and everywhere only twenty-four hours in the day ; and this makes the limitation of the hours of labour by international agreement technically a simple matter. But wage standards are infinitely diverse and difficult to measure—for are we to measure wage-rates or earnings ? Are we to take as our standard money wages converted into a uniform currency on a gold basis, or real wages estimated in terms of the purchasing power of the money wages actually paid in the different countries concerned ? And are we to aim at eliminating existing differences in national wage-rates, which are at any rate in part the result of differences in national productivity ? Obviously it is impossible to aim at uniformity of wage-rates for all countries ; but if we are not to do this what standards are we to take ? Presumably the only workable course would be that of taking the existing wages in each country as a basis, and providing by international convention for their increase by an agreed percentage all round, subject to such exceptions and variations as might be determined by international agreement for particular trades.

Any project of this sort is certain to be strongly fought both by countries which think they can snatch a competitive advantage from the lack of bargaining power among their own working classes and by capitalist interests in all countries which are hostile to an increase in the share of the national income going to the workers and still unconverted to the view that high wages, commensurate with the advance of industrial productivity, are a condition of prosperity. But failing some agreement to raise wage-rates a revival of World Capitalism can give but a short-lived prosperity as the prelude to another depression.

The Time Factor. I have tried in the foregoing pages to outline as moderately as I can what seem to me to be the

essential conditions of any real attempt at the rebuilding of the capitalist system. But as I have written them I have been very conscious—as no doubt the reader has been conscious—that, while each of the things which I have put forward is not impossible—very difficult as it may be to envisage its adoption—cumulatively the entire programme of capitalist reform involves so many obstacles and invites the hostility of so many vested interests, national and sectional, that its adoption as a whole seems infinitely unlikely and remote. I may be wrong in this ; possibly the scaring of world Capitalism is proceeding now at so rapid a rate that in the very near future capitalist countries will be prepared to take steps far more drastic than any they would listen to to-day. Possibly, on the other hand, I have over-estimated the magnitude of the changes necessary for a reconstruction of Capitalism which will at any rate enable it to last some time longer without positive collapse. The reader must be left to judge ; but I think I am safe in saying that, whether I have over-estimated or under-estimated the measures required and the readiness of the world to adopt them, time is of the essence of the matter. Whatever is to be done must be done quickly if it is to be done at all. And the slow-moving machinery of international conferences and negotiations must be tremendously speeded up if it is to be used with any chance of success. We have seen in an earlier chapter how a few weeks' delay in the acceptance of the Hoover moratorium of 1931 largely spoilt its effects ; and it is still more true that, if the world proceeds to positive tasks of reconstruction, it will have to proceed swiftly and simultaneously over a wide field. Either the League of Nations will have to become something very different from the cumbrous and dilatory instrument which it has been hitherto, or new forms of international collaboration will have to be speedily improvised—as speedily as men showed that they could be improvised during the years of war.

§ 2. THE SECOND ALTERNATIVE—THE SUPERSESSION OF CAPITALISM

THERE remains the alternative that we should direct our attention, not to the reconstruction of Capitalism, but to the speedy setting up of an alternative system in its place. That is in essence the Russian solution, though the form which it would have to take in other countries would differ radically from that which it has taken in Russia. When one sees how vast are the obstacles in the way of an effective rebuilding of the capitalist system, and how pitifully feeble have been the efforts which the nations have made with this object hitherto, one is tempted to cry, Away with this tangle of capitalist debts and tariffs and barriers in the way of trade, nationalist and imperialist sentiments and rivalries, internal wrangling in each country between class and class! Let us cut clean away from all these legacies of the old bad world, and attempt instead the better task of creating a cleaner simpler world based on the spirit of co-operation among men and nations alike.

But suppose we do say this, how are we to set about it? It is easy enough to see how we should set about the task of reconstructing the existing order—difficult though we may realise that task to be. It is a far harder matter to know what we ought to do if we have made up our minds that the old order is rotten past patching, and that the need is to create a new one in its place. For each of us is living within the framework of an existing economic and political system; and the day-to-day problems which he has to face are problems presented to him by that system. Elections are fought for the most part, not on the wider issues of Capitalism *versus* Socialism—for that happens only when the system in operation is on the very verge of collapse—but on smaller immediate issues which appeal more directly to the limited imagination and understanding of the ordinary elector. If we try to escape from the circle of these preoccupations with secondary issues, and to force to the forefront of political consciousness the grand choice between two

alternative ways of organising the order of the economic and political life of the country in which we live, we are apt to feel ourselves voices crying vainly in the wilderness, and to have the sense that the opportunity to play our part effectively in the doing of the things which are being done for good or ill is being lost. Even Socialist parties, as we have seen, have found it very difficult to discover a way of escape from this dilemma ; and most of them have been driven by the exigencies of parliamentary practice and of electioneering to put Socialism in the background and to concentrate far more on immediate and secondary issues of social reform.

The Situation in Russia. For the Russians indeed it is easy enough to put first things first ; for there the Socialists are in power, and the task of constructing the new order is obviously the most immediate and pressing as well as the supreme work needing to be done. The old order has been destroyed ; and there is no question of patching it up so as to make it work. Success and the raising of the standard of life depend absolutely on the speed and skill and energy with which the new system can be got into active operation. There is no time for the Russians to have doubts. They are too busy doing things to spend much energy on anything else. But we in other countries are very differently placed ; for among us the capitalist system is still clanking along after a fashion, though with increasing difficulty, and this increasing difficulty in which it is involved makes more pressing the immediate problem of alleviating the distress to which it gives rise. The provision of adequate maintenance for the unemployed, attempts to palliate the consequences of unemployment by the provision of emergency work, agitation to prevent the social services such as health and education from being undermined on the plea of national economy—things like these present problems which it is impossible for the citizen of Great Britain or of Germany to ignore. And the United States is faced with problems of the same order, though there it is a question rather

of the need to build up speedily great new social services in order to cope with the prevailing distress. Politics turns more and more on these immediate issues as the pressure of world distress grows more intense.

Cure or Palliative? But it is essential to realise that no solution of these problems really helps at all towards finding a way out of the world's economic difficulties. It is essential to solve them on humanitarian grounds; but, if the world does solve them by purely emergency measures for the provision of relief, it must not deceive itself into thinking that it is thereby doing anything effective for the restoration of prosperity. What is fundamentally needed is not to relieve the unemployed but to prevent unemployment from arising; for unemployment, as we saw, is a symptom and not a disease. It is necessary to concentrate our main effort, not on these immediate humanitarian tasks, but on the bringing about of changes which will remove the need for so much salvaging of derelict humanity. The bankruptcy of parties which concentrate exclusively on these immediate measures of relief has been sufficiently shown. If—and that is the alternative which we are now considering—it is not possible to bring about a restoration of Capitalism, or not worth while to attempt it, then it is the duty of the world to get down at once to the fundamental task of changing the basis of its economic system. And it is the duty of every man who believes that this is the situation in which the world is now placed to do everything he possibly can to combat the reluctance of ordinary men and women to face fundamental issues, and to force this one really vital problem of our day and generation into the forefront of political life. Let us try then to outline the policy which ought to be adopted in the developed industrial countries by those who believe that the real interest of the world will best be served, not by an attempt to set Capitalism again on its feet, but by the speediest possible introduction of a Socialist system, and, as conditions are bound to differ too widely from country to country for

generalisation to be very helpful, let us take the position of a citizen of Great Britain who holds this view. What ought he to do?

The Outlook in Great Britain. He has in the first place to realise that the conditions in Great Britain are of such a sort that any revolutionary policy in the Russian sense can be ruled out immediately. The British people neither wants revolution to-day nor can be made to want it by any kind of propagandist appeal. If British opinion is to be converted to the need for really fundamental change, this will be done not by the advocacy of forcible revolution but by the working out and setting before it in the clearest possible terms both of the structure and operation of an alternative Socialist system and of the means by which it is intended to bring about the change. For British opinion will want to know both that the proposed alternative has been devised with adequate technical and administrative competence, so that it is likely to work when it has been brought into being, and that the steps towards it have been so planned as not to involve an intervening period of chaos, disorder and misery, and perhaps the threat of starvation for large sections of the people.

In the last chapter, in our discussion of the essentials of national economic planning, the characteristic institutions of the proposed new order were briefly described. But obviously much more than this brief description, and much more than can be attempted in this book, is needed in order to show how these institutions would actually work. And above all it is the business of those who advocate them to put their proposals in workmanlike shape, and to appear at the bar of public opinion with a showing of technical and administrative competence. It is the greatest weakness of British Socialism to-day that it has not hitherto succeeded in looking competent to carry out the tasks which it has set itself to accomplish. It has fumbled, and seemed far more confident in its denunciations of the existing order than in its adumbrations of the future. This is largely because it has

failed to make use of the large resources of technical and administrative ability among its own followers. A considerable section of opinion among the technical and administrative personnel of the present order is already on its side, and willing to play its part in the working out of construction schemes of economic and social reorganisation. This help will have to be enlisted on a far larger scale, and far more effectively used, before British Socialists can have much hope of winning more than a snatched electoral victory—and such a victory would be of but little use as the basis of a constructive attempt to bring Socialism into being. What is meant by such phrases as national development, economic planning, import and export boards, a national investment board, the socialisation of banking, requires to be worked out in detail, and expressed in a fashion which can be readily understood by the intelligent elector. I am not saying that nothing has been done along these lines ; but it is plain that not nearly enough has been done, and that this is one of the main reasons for the relatively slow progress of constructive Socialist thinking even among those who support the Labour Party in Great Britain.

The Policy of British Socialism. But the formulation of Socialist policy is a matter not only of defining the objective but also of indicating as clearly as possible the means of approach. These two things cannot indeed be kept distinct ; for the laying down of the essential features of the projected new institutions of Socialist economy includes in effect the planning of the methods by which they are to be brought into existence. But clearly any Socialist plan which aims at bringing the key institutions of British society under Socialist control will include far more than even the most forthright Socialist Government can hope to do simultaneously and at once. It is therefore necessary to define the broad stages by which the advance is to proceed, and to reassure public opinion that the effect of the earlier measures will not be so to dislocate the remainder of the economic machine as to prevent it from continuing to

function while the remaining measures are being carried through. This, as we saw in the last chapter, is mainly a question of making the initial attack over a broad enough field to include the key positions, without cluttering up the immediate programme with a mass of secondary issues. The things that must be done at once and simultaneously are the socialisation of the banking system, the creation of agencies for the carrying through of a policy of national investment and national economic development, and the devising of means for preventing a "flight from the pound" and the successful engineering of a financial panic in the early stages of Socialist construction. In comparison with these both immediate measures of social reform and the nationalisation of particular productive industries can afford to wait; for it is in the machinery of banking and finance that the power to keep the economic system working or to bring about its dislocation at any moment resides. Just as it would be fatal to leave this machinery in capitalist hands while attempting the institution of a measure of Socialism elsewhere, it would be indispensable to have it in Socialist hands as the means of influencing in a Socialist direction every branch of the economic system from the very outset of the Socialist regime. If Socialism is the right solution for the British economic problem, then the most urgent task is the clear formulation of the programme and objectives of Socialism within the scope of the measures just outlined.

The American Outlook. But suppose the man or woman whose situation we are envisaging is a citizen not of Great Britain but of the United States. What is he or she to do under the conviction that it is in the best interests of the world that Socialism should as speedily as possible supersede Capitalism in all countries? The immediate adoption of a Socialist policy in the United States is not, as we have seen, within the region of practical politics. For a country cannot have Socialism unless it gets first an effective and closely knit Socialist party with a discipline

of its own, a clearly understood body of social doctrine, and a wide following in the country sufficiently alive to the implications of this doctrine. Obviously then the first step towards Socialism in the United States is the creation of an effective Socialist party. But any such party must not be based on a mere imitation of other Socialist parties or a mere parroting of the Socialist doctrines of Europe ; for it will have to work out a Socialism of its own appropriate to the very different economic conditions of the United States. I make no pretence to be able even to begin the formulation of this American Socialism ; for clearly the task could be undertaken only by Americans themselves, and there has been hitherto too much Europeanism in the policies of American Socialist and Radical organisations. But the world depression gives the Americans a far better chance than they have ever had before of formulating successfully a Socialism of their own. The main reason why in the past there has been little impetus towards the development of constructive Socialism in the United States has been that American Capitalism has on the whole been working too successfully and with too great unexploited resources still at its disposal for radical economic change to become a practical policy. The day of American Socialism may not be yet ; but in the light of the events of the past few years its coming may be much nearer than most Americans even now imagine.

Socialism and Internationalism. In both this chapter and the last, I may seem so far to have defined the policy of Socialism too much in national terms, whereas the proposed measures for the reconstruction of Capitalism were almost all essentially international. The explanation is simple. Each country, except Russia, has already its own national capitalist system ; and, while internal changes in each of these systems are essential if Capitalism is to survive, the main task for those who believe in the rehabilitation of Capitalism is to guard it against the consequences of international disharmonies and lack of organisation. If

Capitalism is to be reconstructed in the world as a whole, it must be reconstructed on a world basis and mainly by measures of an international scope. Socialism, on the other hand, however fundamentally international it may be in its policies and projects, has to be built up largely within each country, for the creation of international Socialism will only become possible when the nations or a sufficient number of them have become Socialist. Socialism is forced to be national in its measures, though it is essentially international in its aims. Of course, it has to strive from the first to complement its national measures of planning and economic development with international measures of a similar kind over the widest possible field. International planning is the logical correlative of national planning, and must be based on the widest possible organised exchange of goods between Socialist nations. The object of building up social controls over the import and export of commodities is not that of decreasing the volume of goods passing in international trade, but rather that of promoting a great extension of economic co-operation between countries on a basis of organised exchange of surpluses. Socialism is incompatible with Free Trade in the old sense ; for Free Trade becomes meaningless when States and corporations acting on their behalf, and not individuals, are the buyers and sellers of goods at wholesale. But freedom of trade in a different sense, through the taking of the utmost advantage of the different productive capacities of different parts of the earth's surface and the varying skills of different sections of the world's population, is an essential element in the Socialist economic scheme. The world cannot, however, have international economic planning save on a basis of national economic planning ; for there must be national plans to be co-ordinated by international agency. Each national plan will indeed be profoundly modified by the national plans of all the other countries ; and there will have to be a strong agency for broadening the basis of planning from the area of one nation until it covers the interchange of commodities over the whole world. But inevitably

national planning comes first in the order of progress; and it is the first duty of Socialists to win and use effectively power to reorganise the economic life of their own countries. Socialism indeed, unlike capitalist Internationalism, aims at transcending national frontiers altogether and at linking up the whole world, not perhaps into a single State, but into a federation of closely co-operating groups not sharply divided off into areas each subject to its own limited sovereign authority. One of the greatest tasks of the future is that of building up a workable structure of world government, based not on independent Socialisms but on a cosmopolitan co-operation that recognises no absolute boundaries between State and State.

Towards World Unity. The political system of Soviet Russia already represents for the vast territory and population of the Soviet Union, with its mingling of nationalities and cultures, the attempt at a federal union transcending national boundaries. As we have seen, the supreme government of the U.S.S.R. is vested in a huge Congress of over fifteen hundred delegates from all parts of the area under Soviet control; and it is clearly contemplated in the Soviet Constitution that membership of the U.S.S.R. should be open to other areas, whether or not they form parts of the pre-war Russian Empire. Western opinion is apt to say in criticism of this system that so vast a Congress, meeting only for a brief period, can have little reality, and to regard the Executive Committee elected by the Congress as undemocratic. For there is a strong prejudice in countries that have become accustomed to parliamentary institutions against the method of indirect election. But, if the world wishes to evolve a federal government transcending national boundaries, it will have to make the difficult choice between a mere union of Governments such as the present League of Nations and an attempt to create some kind of democratic assembly drawn direct from the peoples of the various countries. Each form of organisation has its weakness. A union of Governments

fails to break down national barriers, and results in a persistence of the idea of the Sovereignty of each individual State ; while a congress directly representative of peoples has, in order to be representative, to be so large as to be unwieldy and unusable directly as an instrument of government—so that in order to act at all it has to choose from its ranks some smaller body to which it can delegate the greater part of its powers. There is, however, much to be said for the second type of government rather than the first ; for if the world is to live in peace and unity it will have, in spite of all the difficulties in the way, to develop forms of international organisation much closer than the mere coming together of the representatives of a number of different States. There will have to be some body representing the idea of world unity as against the national separatism of each particular Government ; and it is clear that any attempt to reproduce the institutions of parliamentary democracy over this wider field is bound to break down.

I am not suggesting that the world is likely to leap straight from the conception of State Sovereignty to that of a unified world community governed finally by a representative assembly drawn from every country. Probably there will be an intermediate stage, during which there will arise international institutions covering not the whole world but only groups of countries—for example, a federal assembly for the whole or the greater part of Europe. But it is vital, if the federation of Europe is to have any independent life of its own and to transcend national differences, that it should have a superior status to the Governments of the countries entering into the federation ; and the problem of international organisation in the future is to make a supranational body of this type workable in practice. It will not be workable unless there is behind it an effective force of internationally organised opinion, embodied in a party or fellowship with an organisation extending throughout the countries included within the federation. If, then, the future lies with Socialism rather than Capitalism, this means that the Socialist movement will have to develop a

much more closely knit and disciplined international organisation, based on a wider community of ideas and policy than at present exists. This is not to say that Socialism is to lose its national character and become a purely cosmopolitan movement recognising no national differences ; but it does mean that if Socialism is to create for the world the right forms of international as well as national organisation it must itself be so organised on an international scale as to give substance and coherence to the institutions of international administration which the world so sorely needs.

The Choice Before Us. I end this book, not with a dogmatic presentation of the course that the world must follow, but with a series of questions. There are two alternatives before us—a reconstructed Capitalism or a plunge into the unknown seas of Socialist experiment. Each of these alternatives presents serious difficulties of its own. The reconstruction of Capitalism demands from national Governments and national capitalist groups an ability to think far more clearly, and to act with a far greater degree of promptitude and unity than they have yet shown. It involves at the least radical changes in the structure of Capitalism itself and the infusion of a large element of collectivisation into the productive system and of far more equality into the system of distribution. And these changes must be made speedily and thoroughly if, in Western Europe at any rate, Capitalism is to stand a chance of survival. On the other hand, the establishment of Socialism makes even greater demands upon human sagacity and courage ; but at the same time it offers more hope because it promises an appeal to powerful motives in the minds of men which Capitalism has allowed to rust unused. Between these two courses the world has to make up its mind ; and the sooner its mind is made up the better. For, while there is something to be said for trying either course, to hover doubtfully between the two is certain to bring disaster. The world's weakness in facing the problems

of the past few years has been largely the result of this uncertainty ; for men cannot act effectively unless they first make up their minds what they are trying to do. The world has to choose either Capitalism or Socialism, and then to put every ounce of effort at its command into promoting the success of whichever objective it has decided to pursue. My own choice is for Socialism ; for I believe that the capitalist system has done its work and outlived its strength and usefulness in developing the forces of production that are at men's command. Naturally I want other men to think as I do, and to strike out boldly for the introduction of a Socialist system ; but I am well aware that half-hearted efforts to achieve Socialism are worse than useless in that they merely weaken Capitalism without putting anything in its place. If we want Socialism rather than Capitalism, we must make up our minds to struggle for it with all our heart and with all the strength of which men are capable when they make up their minds what they want and act in unity for the realisation of their aims.

A SHORT BOOK-LIST

* Elementary. † Difficult.

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SIR A. SALTER Recovery *Bell 1932*

A. LOVEDAY Britain and World Trade *Longman 1931*

G. D. H. COLE British Trade and Industry, Past and Future *Macmillan 1932 ;* Economic Tracts for the Times *Macmillan 1932*

*F. W. PETHICK LAWRENCE This Gold Crisis *Gollancz 1931*

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LEAGUE OF NATIONS The Course and Phases of the World Economic Depression *League of Nations, revised 1932 ;* The Agricultural Crisis, 2 vols. *League of Nations, 1931–2*

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M. M. KNIGHT, H. E. BARNES and F. FLÜGEL Economic History of Europe in Modern Times *Allen & Unwin n.d.*

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I. LIPPINCOTT Economic Development of the United States *Appleton, revised 1927*

L. C. A. KNOWLES Industrial and Commercial Revolutions in Great Britain *Routledge, revised 1924 ;* Economic Development in the 19th Century, France, Germany, Russia and U.S.A. *Routledge 1932*

*A. VIALLATE Economic Imperialism during the Last Fifty Years *Macmillan 1923*

*R S. LAMBERT Economic Imperialism *Longman 1928*

L. S. WOOLF Empire and Commerce in Africa *Allen & Unwin n.d.*

L. FISCHER Oil Imperialism *Allen & Unwin 1926*

†H. FEIS Europe, the World's Banker *Yale University Press 1930*

A. L. BOWLEY The Economic Consequences of the War *Thornton Butterworth 1930*

C. ECONOMIC THEORY

*J. A. Hobson The Science of Wealth *Thornton Butterworth n.d.* †Wealth and Life *Macmillan 1929*

G. Cassel Fundamental Thoughts in Economics *T. F. Unwin 1925*

Karl Marx Capital Translation by E. and C. Paul *Allen & Unwin 1928*

A. Marshall Principles of Economics *Macmillan, revised 1925*

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[There are, of course, countless text-books—e.g. *Todd's *Science of Prices*, Seligman's *Principles of Economics*, Taussig's *Principles of Economics*, Cassel's *Theory of Social Economy*]

D. PRICES

Sir W. T. Layton An Introduction to the Study of Prices *Macmillan revised 1920*

J. A. Todd The Fall of Prices *Oxford University Press 1931*

†J. W. Angell Theory of International Prices *Harvard University Press 1926*

E. MONEY AND BANKING

*R. A. Lehfeldt Money *Oxford University Press 1926*

*W. Leaf Banking *Thornton Butterworth n.d.*

E. A. Goldenweiser The Federal Reserve System in Operation *McGraw 1925*

J. M. Keynes Tract on Monetary Reform *Macmillan 1923*; Treatise on Money *Macmillan 1930*

†Committee on Finance and Industry Report *Stationery Office 1931*

*R. G. Hawtrey The Gold Standard in Theory and Practice *Longman 1927*; †Currency and Credit *Longman, revised 1928*

T. E. Gregory The Gold Standard and its Future *Methuen 1932*; Foreign Exchange *Oxford University Press 1921*

*G. D. H. Cole Gold, Credit and Employment *Allen & Unwin 1930*

C. H. Kisch and W. A. Elkin Central Banks *Macmillan 1928*

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*H. Withers Bankers and Credit *Nash and Grayson 1924*

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F. UNEMPLOYMENT AND INDUSTRIAL FLUCTUATIONS

Sir W. H. Beveridge Unemployment *Longman, revised 1930*
P. H. Douglas and A. Director The Problem of Unemployment *Allen & Unwin 1931*
H. Clay The Post-War Unemployment Problem *Macmillan 1929*
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†W. C. Mitchell Business Cycles *University of California 1913*
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G. FOREIGN TRADE AND TARIFFS

J. Donaldson International Economic Relations *Longman 1928*
W. S. Culbertson International Economic Policies *Appleton 1925*
O. D. Donne European Tariff Policies *Adelphi Co. 1928*
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C. Brooks This Tariff Question *Arnold 1931*
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[See also the books by Loveday, Cole and Richardson under Section A]

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W. J. Schultz American Public Finance and Taxation *Pitman 1932*
H. Dalton Public Finance *Routledge, revised 1930*
H. A. Silverman Taxation, its Incidence and Effects *Macmillan 1931*
J. A. Hobson Taxation in the New State *Methuen 1919*
†E. R. A. Seligman Studies in Public Finance *1925*
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E. Rignano The Social Significance of Death Duties *Douglas 1925*
Committee on National Debt and Taxation Report *Stationery Office 1927*
L. V. Birck The Scourge of Europe [Debts] *Routledge 1926*
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H. LEVY Monopolies, Trusts and Cartels in British Industry *Macmillan, revised 1927*

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*W. MEAKIN The New Industrial Revolution *Gollancz 1928*

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*H. J. LASKI Communism *Thornton Butterworth n.d.*

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*S. and B. WEBB The Decay of Capitalist Civilisation *Fabian Society*

[See also Cole, *Next Ten Years* (Section I), Laski, *Communism* (Section J), Marx, *Capital* (Section C)]

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